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HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

SEVENTY-SECOND CONGRESS
FIRST SESSION

ON

H. R. 4, H. R. 4604, H. R. 4638
H. R. 4639

FEBRUARY 15, 17, 19, 24, 1932

Serial 5, Part I

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SHORT SELLING OF SECURITIES

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE NO. 3 OF THE COMMITTEE ON THE JUDICIARY,
Monday, February 15, 1932.

The subcommittee met at 10 o'clock a. m., Hon. Henry St. George Tucker (chairman) presiding.

Mr. TUCKER. Gentlemen we have met this morning to take evidence on the bills relating to short selling. There are four bills before us, I believe—H. R. Nos. 4, 4604, 4638, and 4639, introduced respectively by Mr. LaGuardia, Mr. Kelly of Pennsylvania, and the last two by Mr. Sabath.

The bills are as follows:

[H. R. 4, Seventy-second Congress, first session]

A BILL To protect banking and commerce against short sales of securities issued by corporations engaged therein

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, This act shall be known by the short title of "The secur ties short sales act."

SEC. 2. As used in this act the word "bank" or "banks" shall mean and include a bank, banking association, or trust company organized and operating under the laws of the United States or a member of a Federal reserve bank;

the word "banking" shall mean and include the business transacted by a bank or banks; the word "commerce" shall mean and include all the commerce among the several States of the United States, within a District or Territory of the United States, between a State, District, or Territory of the United States and any State, District, Territory, or possession of the United States and any foreign nation; the word "security" or "securities" shall mean and include any stock, bond, debenture, scrip, warrant, or other evidence of interest in or indebtedness of a corporation; the words "stock exchange" or "stock exchanges" shall mean and include any board, market, exchange, or association, however organized or conducted and whether incorporated or unincorporated, where a security is purchased and sold or offered for purchase and sale; the words "member" or "members" shall mean and include every member of or stockholder in or person authorized to transact business as a broker or trader on or at a stock exchange, the words "sale," "sales," or "purchase and sale" shall mean and include every sale, agreement of sale, or agreement to sell; the word "person" shall be construed to import the plural and singular and shall mean and include individuals, associations, trusts, partnerships, and corporations; and the words "short sale" and "short sales" shall mean and include every sale of a security in consummation of which there is delivered by or on behalf of the seller a security not bona fide owned by such seller at the time of making such sale.

SEC. 3. The puchase and sale of the securities issued by corporations engaged in banking or commerce occur largely on stock exchanges. The prices involved in such transactions are quoted and disseminated throughout the United States and foreign countries and constitute the market value of such securities. This market value furnishes the basis for all transactions in such securities, for the lending by banks of money and credit on the faith of such securities, for the financing of the corporations issuing such securities, and for the effect thereof on banking and commerce. These prices are susceptible to speculation and manipulation by the short sale of such securities. Such short sales may, and from time to time do, recur in large volume. They exert a vicious influence and produce abnormal and disturbing declines of prices that are not responsive to actual supply and demand. They constitute a constant possible menace to the market value of such securities and the basis which such market value furnishes. The purchase and sale of such securities are the purchase and sale of an undivided interest in the banking or commerce carried on by the corporations which issue the securities. Such transactions are affected with a public interest. The arbitrary and abnormal decline in prices produced by short sales induces needless liquidation in these securities, creates dissatisfaction with the corporations which issue such securities, destroys the credit extended on the faith of such securities, undermines confidence in the banks which have extended such credit, causes hoarding, and seriously impairs and directly affects the banking and commerce of this country. Such short sales of these securities constitute an unnecessary practice, which obstructs, burdens, and endangers banking and commerce and renders regulation in that respect imperative for the protection of banking and commerce and of the national public interest therein.

SEC. 4. No short sale of a security issued by a corporation engaged in banking or commerce (except by a person doing an odd-lot brokerage business solely for the account and in the usual and ordinary course of such business) may be made on or at a stock exchange, unless—

(a) Such short sale shall be accompanied by a statement, in the form prescribed by the Federal Trade Commission for that purpose, signed by the seller or his broker or agent on his behalf, which shall truly set forth the kind and amount of the securities so sold, the names and addresses of the seller, buyer and their respective brokers or agents, and such other relevant data as the Federal Trade Commission may require in that respect;

(b) The stock exchange each day, upon the close of its business, shall cause a faithful summary of the statements accompanying short sales made on or at such stock exchange that day to be prepared, in such form as the Federal Trade Commission may prescribe for that purpose, and a copy of this summary to be posted at the place of business of such stock exchange and published in a newspaper of general circulation in the city or town where such stock exchange is located or operates, in a manner that will make the contents of such summary plainly and readily available to the public;

(c) The stock exchange shall keep a record, in such form as the Federal Trade Commission may prescribe for that purpose, truly setting forth all loans

of such securities for delivery in consummation of such short sales, with a description of the securities so lent and the names and addresses of the lender and borrower and their respective brokers or agents in that respect; and

(d) The stock exchange shall preserve such statements, summaries, and records for the period of two years and keep them open at all times during such preservation to the inspection of the Federal Trade Commission and its accredited representatives.

SEC. 5. No bank may directly or indirectly make or continue any loan or advance of money or credit to or for the account of a stock exchange or to or for the account of a member thereof or to or for the account of a firm in which such member is a partner or by which such member is employed, for use in the business of such stock exchange or for or in connection with the purchase or sale on or at such stock exchange of a security issued by a corporation engaged in banking or commerce, unless such stock exchange is complying with the provisions of section 4 of this act and requiring the statements and making, posting, publishing, and preserving the summaries and records as specified in that section.

SEC. 6. No bank and no corporation engaged in commerce may list or permit to be listed or to remain listed a security issued by it on a stock exchange, unless such stock exchange is complying with the provisions of section 4 of this act and requiring the statements and making, posting, publishing, and preserving the summaries and records as specified in that section.

SEC. 7. No stock exchange or member thereof or firm in which such member is a partner or by which such member is employed may send or receive, or permit or cause to be sent or received, in commerce or by the use of the Postal Service of the United States, any communication, quotation or information of or concerning a short sale of a security issued by a corporation engaged in banking or commerce which has been made or is to be made on or at such stock exchange, unless such stock exchange is complying with the provisions of section 4 of this act and requiring the statements and making, posting, publishing, and preserving the summaries and records as specified in that section.

SEC. 8. Authority to enforce compliance with the provisions of this act is hereby vested in the Federal Trade Commission, to be exercised as follows:

(a) Whenever the commission shall have reason to believe that any person is violating or has violated any of the provisions of this act, it shall issue and serve upon such a person a complaint stating its charges in that respect and containing a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint. The person so complained of shall have the right to appear at the place and time so fixed and show cause why an order should not be entered by the commission requiring such person to cease and desist from the violation so charged in said complaint. Any person may make application, and upon good cause shown, may be allowed by the commission to intervene and appear in said proceeding by counsel or in person. The testimony in any such proceeding shall be reduced to writing and filed in the office of the commission. If upon such hearing the commission shall be of the opinion that any of the provisions of this act have been or are being violated, it shall make a report in writing in which it shall state its findings as to the facts and shall issue and cause to be served on such person an order requiring such person to cease and desist from such violation, in the manner and within the time fixed by said order. Until a transcript of the record in such hearing shall have been filed in the Circuit Court of Appeals of the United States, as hereinafter provided, the commission may at any time, upon such notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any report or any order made or issued by it under this section.

(b) If such person fails or neglects to obey such order of the commission while the same is in effect, the commission may apply to the Circuit Court of Appeals of the United States, within any circuit where the violation complained of was or is being committed or where such person resides or carries on business, for the enforcement of its order, and shall certify and file with its application a transcript of the entire record in the proceeding, including all the testimony taken and the report and order of the commission. Upon such filing of the application and transcript the court shall cause notice thereof to be served upon such person and thereupon shall have jurisdiction of the proceeding and of the questions determined therein, and shall have power to make and enter upon the pleadings, testimony, and proceedings set forth in such transcript a decree affirming, modifying, or setting aside the order of the commission. The findings of the commission as to the facts, if supported by testimony, shall be conclusive. If either party shall apply to the court for

leave to adduce additional evidence and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the proceeding before the commission, the court may order such additional evidence to be taken before the commission and to be adduced upon the hearing in such manner and upon such terms and conditions as the court may deem proper. The commission may modify its findings as to the facts or make new findings, by reason of the additional evidence so taken, and it shall file such modified or new findings which, if supported by testimony, shall be conclusive, and its recommendations, if any, for the modification or setting aside of its original order, with the return of such additional evidence.

(c) Any party required by such order of the commission to cease and desist from a violation may obtain a review of such order in said Circuit Court of Appeals by filing in the court a written petition, praying that the order of the commission be set aside. A copy of such petition shall be forthwith served upon the commission and thereupon the commission forthwith shall certify and file in the court a transcript of the record as hereinbefore provided. Upon the filing of the transcript the court shall have the same jurisdiction to affirm, set aside, or modify the order of the commission, and with respect to additional evidence, as in the case of an application by the commission for an enforcement of its order, and the findings of the commission as to the facts, if supported by testimony, shall in like manner be conclusive.

(d) Such proceedings in the Circuit Court of Appeals shall be given precedence over other cases pending therein and shall be in every way expedited. The jurisdiction of the Circuit Court of Appeals of the United States to enforce, set aside, or modify orders of the commission shall be exclusive. No order of the commission or judgment of the court to enforce the same shall in any wise relieve or absolve any person from any liability under the antitrust laws. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court upon certiorari, in like manner as is provided in that respect for a review of other final judgments and decrees of such courts.

(e) Complaints, orders, and other processes of the commisison under this section may be served by anyone duly authorized by the commission, either (a) by delivering a copy thereof to the person to be served, or to a member of the partnership to be served, or to the president, secretary, or other executive officer, or a director of a trust, association, or corporation to be served; or (b) by leaving a copy thereof at the principal office or place of business of such person; or (c) by registering and mailing a copy thereof addressed to such person at his principal office or place of business. The verified return by the person so serving said complaint, order, or other process, setting forth the manner of such service, shall be proof of the same, and the return post-office receipt for said complaint, order, or other process registered and mailed as aforesaid shall be proof of the service of the same.

(f) Each order to cease and desist entered by the commission under the authority conferred upon it by this section shall be promptly published in a newspaper of general circulation where the person whom such order directs to cease or desist resides or has his principal place of business, and such publication shall be notice to all concerned of the entry and contents of such order.

(g) For the exercising of the authority hereby conferred upon it for the efficient execution and enforcement such investigations as it may deem necessary to ascertain the facts relevant to any alleged violation of any of the provisions of this act, and in order to provide information for the use of Congress, the commission may make provisions of this act.

SEC. 9. For the purpose of this act, the act, omission, or failure of any official, director, agent, or other person acting for an individual, association, trust, partnership, or corporation within the scope of his office or employment shall be deemed the act, omission, or failure of such individual, association, trust, partnership, or corporation, as well as of such official, director, agent, or other person; but no act, omission, or failure of a bank or of a corporation engaged in commerce, or of any officer, director, agent, or employee thereof, shall constitute a violation of either section 5 or section 6 of this act, if such act, omission, or failure shall be in reliance upon the truth of a certificate by such stock exchange, executed and verified by two of its officers, setting forth compliance by such stock exchange with the provisions of section 4 of this act, provided such certificate shall be in the form prescribed by the Federal Trade

Commission for that purpose and shall not have been superseded by a cease and desist order against such exchange entered and published as provided in section 8 of this act.

SEC. 10. The Federal Trade Commission is hereby further authorized, at such time or times and for such period or periods as in its judgment the circumstances may require, (1) to suspend short sales on any stock exchange of any security issued by a corporation engaged in such banking or such commerce, and (2) to prohibit from engaging in such banking or such commerce any corporation which allows any security issued by it to remain listed upon a stock exchange which does not conform to an order made and entered by the Federal Trade Commission under and pursuant to the provisions of this act. All the provisions of section 8 of this act are hereby made applicable to the authority conferred on the Federal Trade Commission by this section.

SEC. 11. Any person who shall violate any of the provisions of this act shall be deemed guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than $1,000, or imprisoned for not more than ninety days, or both, together with the costs of prosecution; provided that if such violation constitutes also a failure or neglect to obey a cease and desist order entered and published by the Federal Trade Commission under the terms of section 8 of this act, then, upon conviction of such violation, such person shall be fined not more than $10,000, or imprisoned for not more than one year, or both, together with the costs of prosecution. Each day of such violation shall constitute a separate offense.

SEC. 12. If any part or provision of this act shall for any reason be adjudged by a court of competent jurisdiction to be invalid or inapplicable to any person or circumstance, either in whole or in part, such judgment shall not affect, impair, or invalidate the remainder thereof or render such part or provision inapplicable to other persons or circumstances, but shall be confined in its operation entirely to the part or provision thereof, and its application, directly involved in the controversy in which such judgment shall have been rendered.

[H. R. 4604, Seventy-second Congress, first session]

A BILL To regulate certain transactions in securities in interstate commerce, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That it shall be unlawful for any person to deliver for transmission through the mails or in interstate commerce by telegraph, telephone, wireless, or other means of communication any offer to make or execute any contract, or any confirmation of the execution of any contract, respecting the purchase or sale, either upon credit or margin, of any shares in any corporation or association intending that such contract shall be terminated, closed, or settled according to, or upon the basis of, the public market quotations of, or prices made on, any board of trade or exchange or market upon which such stocks are dealt in and without intending a bona fide receipt or delivery of the same.

SEC. 2. Any person who violates any provision of this act shall be deemed guilty of a felony, and upon conviction thereof shall, if a corporation, be punished by a fine of not more than $5,000 for each offense, and all other persons so convicted shall be punished by a fine of not more than $1,000 or by imprisonment for not more than five years, or both. The prosecution, conviction, and punishment of a corporation hereunder shall not be deemed to be a prosecution, conviction, or punishment of any of its officers, directors, or stockholders.

SEC. 3. This act shall take effect on the sixtieth day after the date of its approval.

[H. R. 4638, Seventy-second Congress, first session]

A BILL To prohibit communication of false information with respect to securities in certain cases

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That no person shall transmit or attempt to transmit through the mails or shall communicate or attempt to communicate in interstate commerce any false information affecting or tend-

ing to affect the price of any security listed on any stock exchange if such person knows such information to be false and transmits or communicates it for the purpose of affecting the price of such security.

SEC. 2. Any person violating section 1 of this act shall, on conviction thereof, be fined not more than $5,000 or imprisoned not more than three years, or both.

SEC. 3. For the purposes of this act—

(a) "Person" includes a partnership, association, or corporation as well as an individual.

(b) "Communicate in interstate commerce" means to transmit by any means of communication (other than through the mails) information from one State or the District of Columbia to another State or the District of Columbia.

(c) "Stock exchange" means a regularly established place under the rules of which securities are bought and sold.

(d) "Security listed on the stock exchange" means the stock, debentures, evidences of indebtedness, interest, or ownership of or in any corporation, association, or partnership authorized, under the rules of a stock exchange, to be sold there.

[H. R. 4639, Seventy-second Congress, first session]

A BILL To prohibit short sales of stock

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That no broker shall enter into any agreement on his own account, or on behalf of any other person, for the transfer of stock on any stock exchange unless such agreement involves a bona fide transfer of stock, the title to which, at the time the agreement to transfer is made, is in the person on whose behalf or for whose account the stock is to be transferred. Any broker violating this section shall, upon conviction thereof, be fined not more than $5,000 or imprisoned not more than one year, or both.

SEC. 2. For the purposes of this act the term—

(a) "Broker" means any person authorized under its rules to transfer stock at a stock exchange;

(b) "Stock" means shares or certificates of stock, or of profits, or of interest in profits, or accumulations in any corporation, or to rights to subscribe for or to receive such shares or certificates, or any paper, memorandum, or other evidence of ownership of any of the forego'ng; and

(c) "Person" includes a corporation, partnership, or association, as well as an individual.

The committee will hear Mr. Sabath first, to state the object of his bill.

We will hear you for 10 minutes at this time, Mr. Sabath. Will that time be sufficient for you?

STATEMENT OF HON. ADOLPH J. SABATH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. SABATH. Mr. Chairman and gentlemen, I will require much more than 10 minutes; but I am willing to be brief this morning, as I understand that there are several gentlemen from out of town who would like to make their statements and return to their places of business or to their homes.

Mr. TUCKER. Yes.

Mr. SABATH. And all I wish to say this morning—so as to give these gentlemen an opportunity to be heard—is this:

My first bill on short selling was introduced about 22 years ago. It is not before us, however, to-day. [Laughter.] There are bills that I have introduced at this session, and there is also the bill introduced by Mr. LaGuardia, and there is another bill introduced by Mr. Kelly.

Personally, I am not wedded to any proposition. I am interested in the principle. My aim is to eliminate what we term "short selling," or "bear raiding," which, to my mind, is responsible for the conditions now existing. It is the greatest evil that has been permitted or sanctioned by the Government that I know of; and it is absolutely necessary, in the interests of the Nation, that some legislation be had along these lines.

Of course, I am delighted to know that the stocks went up last Thursday, Friday, and Saturday. And I was wondering whether that had anything to do with the hearings here to-day—and I am inclined to think that it had; because I have known of three such experiences before, in 1929, in 1930, and again in 1931.

When Great Britain went off the gold standard, all the gambling institutions or stock exchanges were closed with the exception of France; and the Stock Exchange of New York did not know whether to close or what to do to prevent what they termed "a great big panic."

But, instead of closing, they came to the conclusion that, if they stopped short selling—something that I have been advocating strenuously since October, 1929, before the crash—that that would save their institution and the country. And they did order that no short selling be permitted that morning, when the sad news was broadcast throughout the world that Great Britain had gone off the gold standard. And instead of there being a great panic on the stock exchange and prices tumbling down from 5 to, perhaps, 25 points, the moment the order came out that short selling was prohibited, notwithstanding the bad news from London, prices immediately started to rise, and they rose from 2 to 10 points. And they rose so fast that within two hours the stock exchange rescinded the order, and Mr. Whitney said it was done because of the fear that the stocks were going up too high.

Now, perhaps a secret order was sent out Thursday or Friday last, showing that they did not want such an order made. And I feel that that is responsible for the favorable conditions on all of the stock exchanges.

Now, in view of the fact that these gentlemen are here from outside the city to-day, I am not going to go into details and give reasons and arguments why legislation must be enacted against this evil that has brought about the deploarable conditions or is responsible to a great extent for the deplorable conditions in this country, from which the entire Nation is suffering to-day. I am satisfied to say that, in 1929, when I appealed to the stock exchanges, if they had stopped short selling, instead of merely sending out a questionnaire for two weeks and then rescinding it—I am satisfied that not one-half of the banks that were closed nor of the factories or other plants that were closed would have been closed; and there would not be 8,000,000 or 9,000,000 people out of employment, nor would there have been over 20,000,000 people who lost nearly all they possessed, due to the manipulation on the stock exchanges.

Now, with that statement, and in view of the fact that it is desired to hear the gentlemen who are here from out of the city, I will yield, requesting that I be given ample time in the near future, or when these gentlemen have concluded, to proceed and give rea-

sons why short selling should be prohibited, or, at least, controlled or limited.

Now, I do not want to be understood—before we go any further I would like to say this—as wanting to destroy the stock exchange; but on the contrary I wish to say this, that to some extent it is performing useful service; and in so far as it will devote its efforts to conducting its business and affairs on legitimate lines, in the interest of the public and of industries, I have no objection to it. But when they start out and utilize, and permit this great organization to be utilized, against the interests of the Nation, not only for speculation, but for pure gambling, dishonest gambling, then I say it is our duty to take steps to make such practices in the future impossible and prevent the repetition in the future of what has occurred in 1929 and 1930, from the effects of which we are still suffering, and will continue to suffer, as long as we permit these invidious practices to continue.

I thank you, Mr. Chairman and gentlemen, for your attention. I think the first person who wishes to address you to-day is Mr. Aron; he will give you his full name and state whom he represents, if anybody, and submit whatever statement he desires to submit to you, and I will desist, for the present.

STATEMENT OF HAROLD G. ARON, NEW YORK CITY

Mr. TUCKER. Mr. Aron, may I ask how long you think you will need?

Mr. ARON. I should think about 30 minutes, Mr. Chairman.

Mr. TUCKER. Very well, sir; you may proceed. May I ask what bill you are going to address yourself to?

Mr. ARON. I am addressing myself to the principle of all the bills rather than to any specific bill.

Mr. TUCKER. You are in opposition to the bills?

Mr. ARON. I am neither in opposition nor in favor of the bills. I am in favor of the principles; whether the bills represent the wisest method of dealing with them I think is a question that should be considered.

It was not clear to me, gentlemen, when I received the invitation of your committee, that there was any special reason for my appearance or that any dereliction would be involved were I to decline. I am not and never have been a member of the New York Stock Exchange and it is perhaps unnecessary to add, never will be; but an active legal and financial career of 25 years has been spent almost within earshot of its trading floor. I am and always have been opposed to short selling of securities, as actually practiced.

Mr. MICHENER. May I interrupt you just there? Some of us are not acquainted with you, and I will ask you, therefore, if you will kindly tell us just what your experience has been and just what your work has been?

Mr. ARON. I have been a lawyer, a financial lawyer, and at various times have been connected with financial institutions having an aggregate capital of upwards of $50,000,000, including banks, surety companies, and insurance companies in this country and banks abroad.

Mr. CELLER. Will you state the names of those banks?

Mr. ARON. I will mention a few of them: International Trust Co. of New York; the National American Bank; the Central Mercantile Bank; the General Surety Co.; the State Title & Mortgage Co.; the Germanic Fire Insurance Co.; the Central Bank for German Industry, and I think there may have been one or two others, but those are some of them.

As I said, I have always been opposed to short selling of securities, as actually practiced. I am convinced that it has contributed as much as any single cause to the present distress of this country. I am of the opinion that, as practiced in the New York Stock Exchange, it is illegal. I am certain that it can be stopped forthwith and should be stopped, and that no permanent and substantial recovery of industry and business can be assured, until it is stopped. I hope it is not necessary to add that these assertions would not be made unless I was convinced of my ability to prove them.

But it is not these convictions which account for my presence here. My determination was reached after reading a public statement of the president of the New York Stock Exchange that he could not help feeling, and I quote him verbatim—

> That the criticism which has been leveled at short selling has been due, in large measure, to the desire of the public to find some simple explanation for the tremendous declines which have taken place in the price of stocks.

It so happens that no such desire can be attributed to me.

In a public address in the summer of 1929, at the height of the market boom, at a financial gathering, which was reported, broadcast, and printed, I discussed banking leadership and asked this question, and again I quote verbatim—

> Finally, has the public not a right to demand that those who call themselves bankers shall not descend to the practices which a generation ago carried the brand of promoter, tipster, manipulator, and worse?

In a similar public address in October, 1929, when the highest opinion in Wall Street stated that the drop in securities was of no more significance than an air pocket, I said, "It is time for nerve, not nerves," and set forth three definite proposals:

> First, that financial leadership should be as positive as it was in 1907; second, that it should be made known that professional short selling at this time has not the approval of the banking world, but is against public interest; and finally, that if sanity is not promptly restored, the stock exchange shall be closed until the public comes to a sober second sense and a realization of its own self-inflicted punishment.

Two weeks thereafter I personally urged upon Mr. Hoover the formation under highest financial leadership of an ad interim corporation with $500,000,000 capital and Government sanction, but not Government participation, to prevent the inevitable calamity of a short-selling campaign then being organized and already in operation.

Last June a financial publication correctly quoted my statement that there could not be a return of prosperity without "the suppression of organized short selling, bear raiding, gang practices, and racketeering on the New York Stock Exchange," and that this should be—

> accomplished by an appeal to justice and patriotism; justice because it is unfair that the public should have their investments impaired by conditions in no way related to economic principles or the earning power, management or

future of the enterprises in which they have invested; patriotism, because a man who would not trade with a national enemy should not trade on the weakened morale of the country.

The article referred to further quoted me correctly as follows:

In order that our formula shall not be illusory, let us not depend on force when there can be none, nor upon discipline when it is ineffectual; rather let the men referred to be brought together without criticism or antagonism and asked, upon their word of honor, to desist for 60 days from their past activities.

The men referred to were described as "say not over 20 men, who are the dominant figures of the 'bear' group on and off the New York Stock Exchange." I also said: "Symbols are used, not because names are unknown, but it will serve no purpose to name them."

I refer to these matters to establish the fact that whatever the president of the New York Stock Exchange may feel about most critics of short selling, in my own case I am at least free from the charge that with me it is an afterthought or an effort to find a scapegoat for the financial depression and industrial crisis.

It is an unpleasant duty, required by the public interest, for me definitely to charge that the official defense of short selling has been special pleading, not supported by the facts and misleading in its attempted conclusions.

Short selling has not flourished on the New York Stock Exchange as an economic safeguard to the Nation's welfare. It has been in the past two years the ruthless efforts of unscrupulous professional speculators to recoup the fortunes lost by overstaying the bull market which ended in the fall of 1929—and fall here has a double meaning.

The importance of your inquiry from a public standpoint is not into the theoretical economics of short selling; it is into the actual practice of short selling as it is conducted day by day on the stock exchanges of this country.

The economics of life insurance were not questioned in the Hughes investigation; it was the practice. The law has ever had to be alert to keep all kinds of insurance from becoming a gambling business, dangerous to the public; but no one has doubted that, properly controlled, it served a useful purpose.

The economics of industrial competition were not the objectives of the inquiries which led to the Sherman Act and the Clayton Act. They were directed against combinations in restraint of trade. In your present inquiry, it is not economic short selling, but organized short selling which concerns you.

Certainly, insurance is an economic and social necessity, and few question the economic wisdom of trade industrial competition.

The true status of short selling has never been ascertained. Economically, it is a matter, as yet, of opinion; but there can be no sincere difference of opinion as to the viciousness of short selling, as it is presently practiced.

Permit me, therefore, briefly, so as not unduly to extend my time, to analyze certain statements made by the president of the New York Stock Exchange in its official defense of short selling of securities. I refer to his broadcast and printed speeches before the Hartford and Syracuse Chambers of Commerce.

Referring to that portion of the Hartford address dealing with short selling, you will first note that many of the statements made as conclusive statements of fact are on their face mere assertions of opinion, and some of the statements not supported by the facts. In answering his own question, "Just what is short selling?" the president of the New York Stock Exchange says:

Let us imagine a man has become convinced——

Mr. CELLER (interposing). What page is that?

Mr. ARON. I have not the exact page number. It is about page 10, of this book [indicating].

Mr. SABATH. It is in that speech he delivered, is it?

Mr. CELLER. There are two speeches.

Mr. ARON. I am talking now about short selling. In answering his own question, "Just what is short selling?" the president of the New York Stock Exchange said:

Let us imagine a man has become convinced that a certain security is selling at too high a price. He feels that it is certain to sell at a lower price in the future and he wishes to take advantage of this situation. To do so, he tells his broker to sell the stock on the stock exchange.

He continues:

You can readily see that a man who thus sells stock short and meets his obligations to deliver by borrowing does substantially the same thing as a man who buys stock and pays for it with borrowed money.

He concludes on this point:

Every man who has sold short is, as I have said, a potential buyer of securities and this is a source of great stability to a market. * * * This is especially true in times of crisis when other people hesitate to buy and the short sellers represent the purchasing power which prevents the market from becoming demoralized. The stock exchange has recognized this fact for many years and has always permitted short selling because it was convinced that no securities market could long continue in business if short selling were forbidden.

Time does not afford any genuine analysis of these statements and their logic. For the moment, let me point out only these natural questions:

Is the short seller then to be ranked as a public benefactor? Why does he feel certain the stock he selects will sell lower; is it because it has been selected for a bear drive? If a man borrows money to buy stock, he presumably intends to own it; is then borrowing stock for a short sale "substantially the same thing" considering the fact that he never intends to own it?

Conceding that every man who has sold short is a potential buyer of securities, since it is bought at lower prices, how can that be a "source of great stability to a market," any more than the existence of a buyers' market in mercantile lines? If it be true that the New York Stock Exchange can not stay in business without short selling, I should take it to be a matter of concern to your committee to find out the precise reason why this is so.

But the most effective answer to the assertions of the president of the New York Stock Exchange is to quote the observations of a member of that exchange, admitted long before the present régime, so that his experience in finance has not been limited to a single depression. And this, gentlemen, while it may seem a bit tiresome, will give you more of the mechanics of short selling than could be ob-

tained in any other way in as few words—and I am quoting from an old member of the New York Stock Exchange:

> One of my early experiences was in the 1906 boom just before the 1907 panic——

Mr. CELLER (interposing). Will you put in the name of that gentleman?

Mr. ARON. Not at this time. I will do it later, if you require it, and I have the necessary consent to doing so.

> One of my early experiences was in the 1906 boom just before the 1907 panic. Great Northern preferred had been rising until the price had reached figures quite as absurd as anything in the recent boom. At 250 I began selling it short in a small way, each time covering at a loss. Fortunately I had a friend who was an old and successful trader (one of the few I have known to make large sums on the short side and keep them). He called me aside one day and said, "Look here, young fellow; quit trying to pick the top of this market or you'll go broke. Wait until the market is definitely over the top and 20 points down on the other side, then sell them and you'll have everybody else selling with you." That is the secret of successful short trading. I might add that Great Northern preferred sold at 348 before starting down.
>
> In the recent boom it was apparent to any intelligent man that Radio, for instance, was high at $100 per share; but that didn't prevent public enthusiasm, plus clever manipulation, carrying it to $400. The "astute traders" of the economists don't fight the market trend and act as a brake on the top. They wait until it is well over the top, then they get behind and push it down as far and as fast as they can.
>
> Short selling without liquidation would, of course, get nowhere. After every period of excessive speculative activity there is bound to be liquidation until that excess is corrected. But undoubtedly the driving of a bold and determined bear clique carries liquidation beyond normal, and causes unnecessary distress and loss to many. Much liquidation would never be brought out except for these bear attacks. When conditions, wholly outside the stock market, bring in extensive liquidation, as has been the case recently, bear attacks needlessly accentuate an already bad situation without corresponding benefits. After all, when liquidation takes place, the stock sold must find a bona fide buyer, with ample funds to protect his purchase, before the liquidation is complete. Often the same stock is sold over and over again to one speculative buyer after another before it finds permanent lodgment. Purchases by shorts have little more than a temporary effect, as their buying is not new buying. They simply turn over the stock purchased to the man from whom they have borrowed it, increasing his liabilities accordingly.
>
> A new buyer, on the other hand, removes the stock from the stock market, reducing the floating supply and relieving the situation to that extent. If short stock was sold in the same way as long stock, there could be no objection; but it isn't. If a bear wishes to sell say 20,000 shares of short stock, he goes in and sells 10,000 shares as carefully as a long would. Then he waits until he find a moment when buying orders in that stock are few, perhaps some day, just before the close, when he will send in several brokers each with orders to sell "at the market" and fairly hurl his second 10,000 shares at the market. This causes a sharp break and brings in frightened selling and perhaps the closing out of some exhausted margin accounts. If his selling brings in the expected liquidation, he will probably cover all or part of the last 10,000 shares and await an opportunity to repeat the operation. Thus he is constantly marking down his main line of stock and making excellent trading profits. If he is a large operator, he will employ some carefully selected propagandist to circulate all sorts of rumors, true and false. Even without a propagandist, if he can drive a stock down spectacularly, Wall Street itself will manufacture rumors galore. It is one of the evils of Wall Street speculation that these rumors crop up from all sorts of unknown sources in both bull and bear markets and mislead a great many innocent people.

To return again to the statement of the president of the New York Stock Exchange, where he is speaking (and again I quote), he said:

> There can be no doubt that it is a lawful practice.

And he cites a decision of Mr. Justice Holmes, in the United States Supreme Court.

I am a lawyer; the president of the New York Stock Exchange, so far as I know, is not. I can not do more, then, than challenge this assertion, which I do if by short selling is meant short selling as practiced on the New York Stock Exchange during the past two years. It has not even been gambling; it has been playing for huge stakes with loaded dice. For 30 years there has been a commonplace saying in stock-speculative circles that "Anyone can talk 'em down, but it takes money to buy 'em up." Since 1930, any reasonably observant person has been aware that there was not sufficient buying power to resist any organized effort to drive stock prices down, if for no other reason than the glut of undigested securities put out during 1928 and 1929. No court has passed on the legitimacy of organized short selling under such conditions.

Mr. TUCKER. You are not quoting from Mr. Justice Holmes now?

Mr. ARON. No.

Mr. TUCKER. You were just now quoting the president of the stock exchange?

Mr. ARON. I was quoting the president of the stock exchange, where he cited a decision of Mr. Justice Holmes, and in his own words says: "There can be no doubt that it is a lawful practice"; those are the words of the president of the stock exchange.

Mr. CELLER. Will you not please read into the record of the opinion? It is very brief, and I think it is very edifying.

Mr. TUCKER. And give the volume and page of the United States Reports?

Mr. CELLER. It is page 5 on this booklet [indicating]. Address of Richard Whitney, president of New York Stock Exchange, delivered before Hartford Chamber of Commerce, October 16, 1931, on short selling.

Mr. ARON. In the booklet the president of the New York Stock Exchange quotes Mr. Justice Holmes.

Mr. CELLER. Well, what is the name of the case from which he cited the opinion?

Mr. ARON. The name of the case is Board of Trade *v.* Christie Grain & Stock Co. (May 8, 1905). That involved, of course, commodities. He quotes from the opinion as follows—I have not checked it. I presume it is a correct quotation:

> Of course, in a modern market, contracts are not confined to sales for immediate delivery. People will endeavor to forecast the future and to make agreements according to their prophecy. Speculation of this kind by competent men in the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want. It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain. This court has upheld sales of stock for future delivery * * *.

Mr. LAGUARDIA. The point that you are making is that the operations of short selling on the New York Stock Exchange are not like the operations under review in the case before the United States Supreme Court?

Mr. ARON. I believe it is a correct statement to say that the president of the New York Stock Exchange himself recognized the distinction between legitimate and illegitimate short selling.

Mr. TARVER. You have several times used the term "organized short selling"?

Mr. ARON. If you will permit me to continue just a moment, I will explain that later.

Mr. CELLER. Let me interrupt you just a minute. That was the case against the Chicago Board of Trade, where the charge was made that the Chicago Board of Trade was running a bucket shop and that its transactions were only wagers?

Mr. MCKEOWN. I suggest that the witness continue his statement.

Mr. ARON. I wanted to discuss that case, but I do not suppose it would be an appropriate time.

Now, continuing the defense, this statement is made unequivocally:

> Competent and impartial economic students both here and abroad have long declared that short selling, by restraining inflation and cushioning sharp decline, tends to stabilize fluctuations of prices.

To this, the questions are relevant: Where was the restraint in 1929; where was the cushion in 1930; where was the stability in 1931? To this assertion, the remark is germane that the entire power of the New York Stock Exchange can not produce before your committee a single economic student of the type described who will, after proper cross-examination, give any such characterization to the practices of short selling here under inquiry. Again, let us offset the remarks of the president of the New York Stock Exchange with these facts recorded by a member of that exchange of transactions on that exchange:

> To give a further idea of the methods of short sellers, when the war boom of 1918 reached its peak one of our cleverest operators became very bearish on United States steel. For weeks he sat in his broker's office doing nothing. Then one day he gave an order to sell 5,000 shares of steel at the market. Before his reports were in, he gave an order to buy 5,000 shares at the market. This was repeated nine times. Each time the market failed to give way under his selling, and he immediately covered. The tenth time the market action suited him, and he immediately gave an order to sell another 10,000 at the market, then 10,000 more, and at the congressional investigation it developed that he was short a huge amount. He made a killing, but he didn't fight the market trend, nor did his selling and repurchasing help to cushion the market. It furnished a very important part of the motive power for the decline.

One other totally misleading argument of the Hartford speech must be adverted to, namely, that the bond market has declined "where short selling is all but impossible." Apparently, then, some securities markets can live without short selling, and what is more to the point, the most potent demonstration of the vice of short selling is the very contagion of panic which it spread to the bond market. This defense is of a piece with that which erroneously asserts that unlisted securities, which can not be sold short, have shown price fluctuations. The simple fact is that unlisted securities can be, are, and have repeatedly been sold short in the past three years.

The Syracuse speech repeats the assertions of the Hartford speech, and draws conclusions from statistics gathered in the meantime by the New York Stock Exchange. Their analysis is impossible here, but they are, at least, subject to conflicting interpretations, to use the euphemism of the president of the New York Stock Exchange.

Let me content myself with the comment of an old member of that exchange:

> In his recent speech, President Richard Whitney, of the New York Stock Exchange, stated that they had been unable to find any "bear raiding." He states that the recent investigation showed an average short account of about 400 shares from which he deduced that there was no large or organized crowd in bear raiding. The prolonged decline has taught many of the public to speculate on the short side, and the present short interest is largely a public short interest, and such a short interest is undoubtedly a market cushion in case of a sudden break. However, had the investigation been made in December, 1930, when the big bear operators were in the midst of their campaign, the result would have been quite different. Everyone who knows his way around be'ow Fulton Street knows that "bear raiding" has always been an accompaniment of every period of liquidation.
>
> During one bear market—

And I think this will answer your question—

> During one bear market, when the writer was a member of the stock exchange a group of powerful floor traders went about the room day after day looking for stocks in which there was weak support. Whenever they found one they would promptly fill up the specialist's book and then trade furiously back and forth between themselves, always on a downward trend, and often succeeded in knocking $2 to $5 off the price in a short time, making a nice profit on their original sale of four or five thousand shares.
>
> Thus on trading in which there was a change of ownership of a few thousand shares, they established the price of an entire issue of several hundred thousand shares, and affected every bank loan and margin account in which there happened to be any of this stock. In this way prices were hammered down day after day and more and more forced liquidation brought out.
>
> There is another phase of bear raiding, as to the moral turpitude of which there can be no question. In at least one instance in this bear market, the "bear raiders" knew of a big loan, secured by a large block of stock of one of our premier corporations which would be called if they could drive the price of that stock to a certain figure. This they immediately did, causing cruel loss to the man who had made the loan. How did they get this information; through some underling in the bank, or did it come from an officer or director? A stockholder and prominent director of one of our largest banks is commonly reputed to have been intimately associated with the big bear crowd.

Finally, gentlemen, I repeat you are not concerned with the academic economics of short selling or theoretical arguments in its favor. You are concerned with short selling as it is and what it has done to this country, and I can not make it one-half so vivid as a recent drawing of a great cartoonist:

A very sick and battered child lies in a cradle marked "Business" spooning its medicine is the President, out of a bottle marked "$500,000,000 credit," held by a nurse with the word "Bankers" on her cap; in the rear, half disclosed behind a curtain is a huge skin labeled "Bear raids," concealing two grinning rapacious figures, out of whose mouths come these words: "Get ready now, boys, we'll scare the daylights out of him again." The cartoon is entitled "Restoring confidence."

Such, gentlemen, have been the real results of the actual practices of short selling, which could have been stopped but have been tolerated by the New York Stock Exchange.

We have seen within the last week the intimate anatomical relationship between the stock market and governmental policies in the present financial situation. The carefully worked out plans for your Reconstruction Corporation and the actual inauguration of its functions found no response in the stock markets, and there was until the close on Wednesday a decidedly down trend, which the large short position on February 1 gave no indication of mitigating. On Wednesday, it was known in Wall Street that the rediscount powers of the Federal Reserve Board were to be liberalized. This was the policy which certain influences in the financial world have long favored, and the stock exchange had the power, as demonstrated by the market action, to withhold recognition of the constructive program of your Reconstruction Corporation, until other legislation which it wanted was assured. When that which it wanted was promised, in such form as to be treated as un fait accompli, it resolved its power into plaudits in the most spectular upward movement of the market in many months, as it had done in connection with the foreign debt moratorium.

This, like the speculative performances of the boom years, naturally focusses public attention on the stock market; it was the gage of prosperity, so called, and it is obviously still being used as a gage. Therefore, artificial and premeditated price movements in security markets have the effect of some one tampering with the air gauge of a submarine, causing it to record inaccurately and without regard to the true condition of the oxygen tanks; of course, this may work either way, perhaps is already working the other way, but that is another matter. In any event, because it has worked disastrously one way, short selling, as it is practiced, becomes a matter of national concern and is, therefore, properly before your committee.

It is always regrettable when the powers of Government must be resorted to in order to regulate trade, commercial, or financial practices; regrettable, first because of the very fact that it has become necessary; regrettable because there is always the possibility that the remedy applied will be neither intelligent nor effective. I have high hopes that this will not be the experience of your committee.

Mr. TUCKER. Mr. Aron, would it be agreeable to you to respond to any questions that the members of the committee may want to ask you?

Mr. ARON. Within limitations.

Mr. TUCKER. Well, sir, we will try to keep within limitations.

Mr. LAGUARDIA. May I ask a question, Mr. Chairman?

Mr. TUCKER. Yes, certainly.

Mr. LAGUARDIA. Mr. Aron, for the purposes of the record, will you describe an example of an operation which is a typical short sale, on the New York Stock Exchange first?

Mr. ARON. Do you mean a typical short sale?

Mr. LAGUARDIA. Yes.

Mr. ARON. A man calls up his broker at 10 or 11 o'clock in the morning and says, "Sell short 100 shares of United States Steel stock." If he has credit with his broker, that is all there is to it. At the end of the day he appears on the broker's books as short so many shares of steel. That is carried in his account, and he does nothing until the market comes down 4 or 5 points. No money has been used in the transaction at all, nothing except credit.

Mr. LAGUARDIA. And he owns no stock?

Mr. ARON. He owns no stock, but he has an agreement with the "loan crowd" so that there may be an actual delivery of the stock at 2.15 o'clock of the day following.

Mr. LAGUARDIA. Will you describe "selling against the box"?

Mr. ARON. It is a method for handling a situation where a man has stock that he wants to keep, and he wants to hedge and reduce the price of his line; and at least in that case he is the owner of stock. He is not the owner of the new stock, but he is the owner of the old stock; and he uses the new stock to reduce the cost of his long line in the stock.

Mr. LAGUARDIA. And besides the effect that the short selling has on the actual and real value of the stock itself, does it affect business in general; that is, buying and placing of orders, and so on?

Mr. ARON. Well, I have had experience which points that way, and undoubtedly others have had the same kind of experience, where merchants and manufacturers are at the point of signing a contract, and then by some unhappy circumstance, the afternoon newspaper is brought in, and it contains headlines that say that the market has dropped 10 points, or that there has been a "bear raid," and the person who is about to make the contract indefinitely postpones it under those conditions.

Mr. LAGUARDIA. Well, of course, whether it is a bona fide sale on the stock exchange, or a short sale, commissions are paid on the sale just the same to the brokers, are they not?

Mr. ARON. Yes, sir.

Mr. LAGUARDIA. And that is what Mr. Whitney meant when he said it was the life of the exchange?

Mr. ARON. Well, I think the stock exchange has a higher purpose than making commissions for the brokers—at least, I hope so.

Mr. LAGUARDIA. Have you read the bill H. R. 4, introduced by me?

Mr. ARON. I have read the bill; yes, sir.

Mr. LAGUARDIA. Now, stripped of the declaration of policy, my bill would provide, first, that short sales—

> Shall be accompanied by a statement, in the form prescribed by the Federal Trade Commission for that purpose, signed by the seller or his broker or agent on his behalf, which shall truly set forth the kind and amount of the securities so sold, the names and addresses of the seller, buyer, and their respective brokers or agents, and such other relevant data as the Federal Trade Commission may require in that respect.
>
> The stock exchange each day, upon the close of its business, shall cause a faithful summary of the statements accompanying short sales made on or at such stock exchange that day to be prepared, in such form as the Federal Trade Commission may prescribe for that purpose, and a copy of this summary to be posted at the place of business of such stock exchange and published in a newspaper of general circulation in the city or town.

And soon.

Now, would that remedy prevent the disasters and the damage now brought about by short selling, and if so, how?

Mr. ARON. Of course, I shall have to answer "No." I will say that it would very materially reduce the danger. It would materially reduce the danger in this respect; that is, to be personal about a transaction: I own, we will say, 100 shares of United States Steel stock. I am an investor, and it is in my box for safe-keeping, and I want it to stay there. The next morning I find that there has been a drop of 5 points in United States Steel. That naturally creates

nervousness on my part, and I am very apt to sell my stock. But if the night before I am informed that a bear crowd had sold short 10,000 or 20,000 shares of United States Steel, I would know that that would have no great significance, and I would keep that stock in my box.

Mr. LaGuardia. Then it would reduce the damage that would be done?

Mr. Aron. Yes; I did say that, but I said it would not cure the situation.

Mr. LaGuardia. Could short selling be stopped entirely?

Mr. Aron. Of course, short selling could be stopped entirely. I do not want it understood that I advocate that it shall be stopped entirely. It has a legitimate purpose.

Mr. LaGuardia. Then you go further than I do in H. R. 4.

Mr. Aron. Further than you do?

Mr. LaGuardia. Yes.

Mr. Aron. Decidedly. If I were going to stop certain practices, I would stop them, and I would not leave a loophole for the law to be evaded.

Mr. LaGuardia. How would you stop them entirely?

Mr. Aron. That is a matter that I would not care to discuss at this time. Personally, I will say that neither I nor any committee of Congress has sufficient information to intelligently deal with short selling.

Mr. Celler. Well, how can we get the necessary information?

Mr. Aron. By a normal inquiry, such as you had in regard to the practices in restraint of trade. And further than that, I will say that I regard this as a greater evil than the practices which led to the Armstrong investigation of the insurance companies in 1906.

Mr. Celler. A greater evil?

Mr. Aron. A greater evil.

Mr. LaGuardia. I have a resolution now which has been introduced, because I was confronted with the very situation which you describe; because in H. R. 4, I provide for going into an investigation of the whole subject of short selling. Do you think that is an absolutely necessary preliminary step?

Mr. Aron. It is an absolutely necessary preliminary step; it is absolutely vital to get sufficient information. It is the first stage of the process, which will answer for the time being.

Mr. Tarver. May I ask a question, Mr. Chairman? You have not distinguished, Mr. Aron, between what you refer to as "legitimate short selling" and "illegitimate short selling." I wonder if you have discussed what, in your judgment, you regard as legitimate short selling, or if you care to do so?

Mr. Aron. I tried to make the distinction, not so much between legitimate and illegitimate short selling, because to a lawyer that is a statement of a conclusion, and not of fact. But I make the distinction between "organized short selling" and "normal short selling." It is a very common experience, and you gentlemen have dealt with it constantly in connection with your conspiracy statutes—what I do individually is one thing. Suppose I am a shopkeeper, and I cut prices in order to drive my competitor out of business. That is regarded as legitimate; that is the law of competition, which is

the so-called heart of trade. But if I and every other merchant in the neighborhood get together and say, "We will all cut prices until we have driven that man out of business," that is an organized conspiracy, and not competition. I make the distinction between normal short selling and organized short selling.

Mr. Tarver. And as I understand you, illegitimate short selling, to your mind, means the same thing as organized short selling?

Mr. Aron. It means the difference between manslaughter and murder. One is premeditated and the other is not.

Mr. LaGuardia. Then would not the requirements in H. R. 4 assist in determining what was organized short selling?

Mr. Aron. Yes; undoubtedly.

Mr. McKeown. May I ask a question? I wanted to ask if one of the vicious things growing out of short selling is not the intermeddling in the stocks of corporations by people who are not interested in the corporations and have no interest in their welfare, and have no interest in the stock at all, but are outsiders and intermeddlers?

Mr. Aron. Of course; I endeavored to point that out. Let me give you an illustration. Take a corporation that has a million shares of stock outstanding—this is just to show the absurdity of it. Now, that corporation to-day is worth $20,000,000 more than it was on last Thursday morning. That was brought about, at least, to a degree—I should think that the advocates of short selling might very readily claim that the rise in the market has been due to them—because short covering had a good deal to do with it. Now, that is a matter of those having no interest in the corporation whatsoever, men who probably have never owned a share in it; in fact, the corporations in which they sell short they would not hold a share in.

Mr. McKeown. No.

Mr. Celler. May I ask a few questions, Mr. Chairman?

Mr. Tucker. Yes; certainly.

Mr. Celler. Every short sale must be completed by a repurchase, Mr. Aron?

Mr. Aron. Yes.

Mr. Celler. And to the extent that a purchase may send stock up, a sale might send it down; is that correct?

Mr. Aron. Yes; except, of course, that the purchase may be made at any time. That is, there is no fixed time within which the purchase must be made, and the short seller naturally awaits his opportunity to buy. Now, if every short sale had to be covered in 48 hours, your argument would be valid. The actual result is the reverse, however, because the short seller waits until the market goes lower before he does cover; so that there is no compensating purchase.

Mr. Celler. Yes, but often factors quite beyond his control, like passage by Congress of the Reconstruction Finance Corporation bill, may send prices up and he must cover, i. e., he must buy, and does the man who buys long always wait for the market to go up?

Mr. Aron. He may wait to get his dividend also.

Mr. Celler. Well, is not one the complement of the other; i. e. the sale of the short seller is neutralized by his subsequent purchase?

Mr. Aron. No.

Mr. Celler. Well, theoretically that is true, is it not?

Mr. ARON. No; it is not even theoretically true.

Mr. CELLAR. Would you not say that any sale tends to make the market go down, and any purchase tends to make the market go up?

Mr. ARON. I do not say that at all. I say this, that it depends on the purpose for which the sales or the purchases are made. It is just like a sale or a purchase of real estate. Does the seller of real estate always want the market to go down?

Mr. CELLER. I believe you stated that you have been interested in banks, and insurance companies, and title companies?

Mr. ARON. Yes.

Mr. CELLER. Are you familiar with the trend of stocks of title companies, insurance companies, and banks before 1929?

Mr. ARON. Yes.

Mr. CELLER. Has there been any short selling of any bank stocks or insurance company stocks or title company stocks?

Mr. ARON. Yes; some.

Mr. CELLER. Well, there has probably been none, in comparison to the short sales of other stocks?

Mr. ARON. Nobody knows. My own opinion is that there has been a good deal.

Mr. CELLER. Do you know of your own knowledge that there has been short selling of those stocks?

Mr. ARON. I know that there has been short selling; the extent of it I do not know; I know where the short selling has been done.

Mr. CELLER. Well, the text-book writers state that bank stock is not loanable for the purpose of perfecting short sales.

Mr. ARON. There are a good many statements in textbooks that do not jibe with the practice. You can find out from bank-stock traders whether it is possible to sell bank stocks short. It is difficult, but it can be done.

Mr. CELLER. Well, in the case of the stock exchange, there is what you call a "loan crowd" or the "loan post," where stock may be borrowed for the purpose of perfecting a short sale; is that right?

Mr. ARON. For the purpose of effecting a short sale?

Mr. CELLER. Yes; for the purpose of effecting a short sale.

Mr. ARON. Yes; that is correct.

Mr. CELLER. There is no such thing as a "loan crowd" or "loan post" in the case of bank stocks, is there?

Mr. ARON. No; but every bank-stock trader would be apt to have stock in his box and might be willing to lend it.

Mr. CELLER. Did you ever personally borrow any bank stock for the purpose of effecting a short sale?

Mr. ARON. No. I have made no short sales, so that I have had no experience in that direction.

Mr. MICHENER. I think that is hardly a fair question.

Mr. CELLER. I will be very glad to withdraw that question, if the gentleman wishes.

Mr. ARON. No; I will be very glad to have that remain on the record.

Mr. CELLER. There have been great declines in bank stocks and insurance company stocks, have there not?

Mr. ARON. Certainly.

Mr. CELLER. Would you say that those declines in those stocks have been the result of short sales or the result of the liquidation that has occurred recently?

Mr. ARON. Banks and insurance companies invest in securities. Short selling reduces the value of securities; that, therefore, reduces the value of the portfolio of the insurance company or the bank and consequently reduces the book value of its stock.

Mr. CELLER. Would you disregard the tremendous overproduction we have had here and the results of the aftermath of the war—with, possibly, the high tariff situation and the complications and revolutions throughout the world—as not having any part or any major part in causing the tremendous liquidation that has occurred in the past few years?

Mr. ARON. First, let me say that what I said on that was that I was of the opinion that short selling was—or let me see how I expressed it—that it has contributed as much as any single cause. I did not say that it is the sole cause, and I have not cosmic mind enough to tell you what is the real cause. There are those who will say that you can be "cured by the hair of the dog that bites you," but I do not know. Nor do I understand the metaphysical distinctions between inflation and counterdeflation.

Mr. SUMNERS. Mr. Chairman, if the witness has finished answering the questions that have been asked him, may I ask a question?

Mr. TUCKER. Yes; certainly.

Mr. SUMNERS. I wanted to ask him this, if the witness has not already stated it for the record: Have you indicated an opinion with reference to the effect of the short selling upon the dividends, directly or indirectly, of the stocks affected? If you have stated that, please do not repeat it.

Mr. ARON. No; I have not. Under the old-time corporate practice there would be practically no effect. But actually, what is happening in a great many large corporations is that, through charter changes and the prevailing provisions of statutes, they are buying in their own stocks and therefore reducing the outstanding shares; and in that respect you may, if you want to carry the argument far enough, say that short selling has reduced to abnormally low levels the market price of their shares, enabling them to buy them in at less than their book value, reducing the number of shares, and in that respect the short selling is an aid to the dividends. That is presenting it one way, if you care to go that far.

The other thing to consider is this, and there is where it has a vital effect on dividends: Any corporate manager of an industrial corporation or a mercantile corporation knows that he must stay liquid. Now, the greater the pressure on the stock market the more intense is his desire to stay liquid. The more he stays liquid, the less money he uses in his business, the more it reduces automatically the essential capital of the company and also causes unemployment.

Mr. SUMNERS. One other question, which seems to me rather an important thing—you have almost covered this, I think, but I would like a definite answer: In your judgment, does short selling, which results, in your theory, in depreciation of prices, hurt the credit of the corporation and thereby reduce its dividends?

Mr. ARON. Yes; indubitably.

Mr. MICHENER. As I understand your statement, there is an evil in short selling; short selling also has its benefits. It is your judgment that there should eventually be legislation remedying the evil; but you have stated to the committee that, in your opinion, the committee does not have, nor the Congress does not have, sufficient authentic evidence which would warrant it in safely embarking upon legislation controlling or regulating short selling at this time. Is that correct?

Mr. ARON. I think that is a fairly correct statement of my viewpoint, if there is no distinction of language there. Congress and the whole country has sufficient evidence as to the evil proceeding from short selling. What we have not, in my judgment, is the economic information upon which to base an intelligent, effective remedy. And I wish, further, to say that I regret it—although I am inclined to believe that events have shown it to be necessary—I regret it that Congress had to meddle in this situation. The stock exchanges should have had sufficient enlightened self-interest to have done it themselves.

Mr. MICHENER. I was also interested in your statement, wherein you called attention to the fluctuation in prices on the stock market within the last few days. Now, the conclusion which one must necessarily draw from your observation is this: That the stock exchange has it within its power and control to make any action by Government officials, executive or legislative, popular or unpopular?

Mr. ARON. I should say that it had the ability to make or unmake public opinion on legislative matters on financial questions.

Mr. MICHENER. In other words, if Congress should pass a law in which the stock exchange was not interested, they could, by manipulation, temporarily, at least, make the effect of such law just the opposite of what was intended by the legislators?

Mr. ARON. You mean the effect upon the public mind?

Mr. MICHENER. Well, the effect economically for the time being?

Mr. ARON. Yes; for the time being, if it were a remedial measure. I would rather question, however, the word "manipulation." A better phrase does not occur to me; but, let us say, by spontaneous combustion within the stock exchange itself.

Mr. MICHENER. That is all.

Mr. LAGUARDIA. You are so careful in your choice of language that I want to call your attention to the fact that in Mr. Michener's question, to which you answered in the affirmative, he said legislation on the subject eventually may be necessary. Now, do you not believe that legislation should be provided in the very near future on this subject?

Mr. ARON. In my original remarks, I said that I was thoroughly convinced that we could not have a substantial permanent recovery in business or industry in this country until the practices of short selling are definitely out of the way.

Mr. CELLER. Mr. Aron, in other words, you think that the stock exchange itself could cure the evils that emanate therefrom?

Mr. ARON. In 24 hours.

Mr. CELLER. Then, why ask for restrictive legislation that may do more harm than good? The constitution of the New York Stock Exchange provides, according to the speech of its president from which you read this morning, that "any member who sells securities

for the purpose of demoralizing the market may be suspended or expelled." Do you think that is correct?

Mr. ARON. I do not state this as my own information; but I state it upon reliable information, that no member of the stock exchange has ever been expelled for that reason.

Mr. CELLER. The difference between you and Mr. Whitney is that you state that there has been evidence of this demoralization, and he says there has been none?

Mr. ARON. No; he said he could not find it.

Mr. CELLER. In other words, there is a difference of opinion between you and him on that score? His word, of course, is as good as yours?

Mr. ARON. I will say it is not a question of opinion. It is a question of fact.

Mr. LAGUARDIA. I may say that I know specific instances of short selling and of misconduct that have been called to the attention of Mr. Whitney and the discipline committee, and no action has been taken.

Mr. TUCKER. Mr. Aron, I have one question that I would like to ask: Has New York any law regulating the actions of the stock exchange in these particulars?

Mr. ARON. No. Every spring the flowers come up, but they never bloom.

Mr. CELLER. Oh, yes, Mr. Aron. You have heard of the act of 1858, have you not? I will read you now from the report of the committee on speculation in securities and commodities of June 2, 1909, which was an investigation conducted by a committee appointed by Hon. Charles E. Hughes, then governor of New York State, and now Chief Justice of the United States; and that committee referred to this act of 1858, which is now in force; it was in force in 1909, when that committee reported, and it is still in force. And I ask the members of this committee to give attention to the wording of that contract of 1858, which I will now read:

> No contract, written or verbal, hereafter made for the purchase, sale, transfer, or delivery of any certificate, or other evidence of debt, due by or from the United States, or any separate State, or for any share or interest in the stock of any bank, or any company incorporated under the laws of the United States, or of any individual State, shall be void or voidable, because the vendor at the time of making such contract is not the owner or possessor of the certificate or certificates, or other evidence of said debt, share, or interest.

Is that not the law of New York State to-day?

Mr. ARON. Will you be fair enough to go back to the chairman's question? He asked me if we had any law in New York, regulating the practices of the New York Stock Exchange, and I answered in the negative.

Mr. CELLER. Well, this is a law that regulates it, to the extent that a man may sell a share of stock in New York that he does not own or possess, and he has a right, therefore, to sell short, in the sense that he does not own that stock when he sells it; and he can, on the next board day, as is the practice of the New York Stock Exchange, borrow that stock for the purpose of effecting the short sale. He then owes that stock to the man from whom he borrowed it. This is, as far as I know, the only statute on the subject, and under this statute the New York Exchange has been operating, and undoubtedly will continue to operate, in effecting short sales.

Mr. ARON. Well, what is the point of the quotation? Of course, short selling is, at the present time, legal. Otherwise, this committee would not be sitting here.

Mr. TUCKER. Is that the only legislation on the subject?

Mr. CELLER. So far as I know it is, Mr. Chairman.

Mr. TUCKER. Is that the only legislation you know of, Mr. Aron?

Mr. ARON. That is the only legislation I know of, and it has been consistently upheld and claimed by the New York Stock Exchange, as to any legislation, that it was a voluntary association, and is not subject to legislative enactments in the State of New York; and any efforts which have been made to compel its incorporation have always been defeated—so as to bring it within the law any more than it now is, when it has the status of a partnership quoad hoc.

Mr. CELLER. We have had a number of investigations of its operations, have we not?

Mr. ARON. Yes.

Mr. CELLER. We have had the Pujo investigation.

Mr. ARON. Yes.

Mr. CELLER. And we had the investigation under Governor Hughes in New York that I referred to.

Mr. ARON. Yes.

Mr. CELLER. And we have had the recent investigation by the Royal Commissioners in Canada, under the guidance of Sir Josiah Stamp. Are you familiar with those investigations?

Mr. ARON. I am familiar with the fact that they have occurred.

Mr. CELLER. In the New York investigation, are you familiar with the language used by the governor's commission on short selling as practiced on the New York Stock Exchange, which is as follows—it is very brief, and I will read only a few paragraphs:

> We have been strongly urged to advise the prohibition or limitation of short sales, not only on the theory that it is wrong to sell what one does not possess, but that such sales reduce the market price of the securities involved.
>
> We do not think that it is wrong to agree to sell something that one does not now possess but expects to obtain. Contracts and agreements to sell and deliver in the future property which one does not possess at the time of the contract are common in all kinds of business. The man who has "sold short" must some day buy in order to return the stock which he has borrowed to make the short sale. Short sellers endeavor to select times when prices seem high in order to sell, and times when prices seem low in order to buy, their action in both cases serving to lessen advances and diminish declines of prices. In other words, short selling tends to produce steadiness in prices, which is an advantage to the community. No other means of restraining unwarranted marking up and down of prices has been subjected to us. The legislation of the State of New York on the subject of short selling is significant.
>
> In 1812 the legislature passed a law declaring all contracts for the sale of stocks and bonds void, unless the seller at the time was the actual owner or assignee thereof, or authorized by such owner or assignee to sell the same.
>
> In 1858 this act was repealed by a statute now in force.

Which statute I have just read to you.

Mr. LAGUARDIA. Does the gentleman from New York take the position, then, of defending the present system of short selling?

Mr. CELLER. No. I make this statement, that there are abuses in short selling; and there are the conspiracies that Mr. Aron speaks of. I have no knowledge of them. They are denied. But if there is a conspiracy we have a law against conspiracy which will not allow the culprits to go unwhipped of justice. However, if you attempt to put any undue burden on short selling, to my mind the cure will be worse than the disease. Short selling serves an adequate and a proper purpose, but it must be properly safeguarded. I believe it is best to leave it to the members of the New York exchange to put their house in order.

Mr. LAGUARDIA. Then the gentleman has been advocating that no action be taken, but to leave everything in the hands of the New York Stock Exchange?

Mr. CELLER. Because every time an investigation has been had, such as the Pujo committee, and I will read a paragraph from that later, it has been indicated that these laws should not pass because they would do more harm than good.

Mr. BACHMANN. Mr. Aron, as I understood from what you said, you do not see any evil in short selling generally. That is, there is some short selling held by you to be all right, but what you are trying to point out to the committee is the fact that these organized efforts at short sales is where the trouble lies. Now, the New York Stock Exchange itself could regulate organized short selling.

Mr. ARON. Within 24 hours.

Mr. BACHMANN. And the fact that it has not done so up to this time is evidence that it does not expect to do so, and therefore the Government should take steps to correct the evil?

Mr. ARON. That is a conclusion for your committee to draw, and you see the point—it is not for me to state it; that is the ultimate fact before your committee.

Mr. CELLER. Is it not for the State of New York, in its police power, rather than the Federal Government?

Mr. ARON. Would you say so when there are 20,000,000 people in the United States interested in the stock market or formerly interested and there has been a shrinkage of 100,000,000,000 on that exchange in the last two years—would you say that entirely concerns the State of New York?

Mr. CELLER. I do not agree with your facts, that short sales brought that about.

Mr. ARON. I stand upon what I said and not upon your interpretation of it.

Mr. TUCKER. That in New York does not give this Congress jurisdiction.

Mr. ARON. Certainly, but if they are effective in different States it makes congressional action mandatory.

Mr. CELLER. Suppose you deny the use of the mails, as one of the bills provides, and deny telegraph and telephone facilities and interstate communications to those who indulge in short selling, would you not then have the situation that those who use those facilities would be restrained and hampered, whereas those who make the short sales within New York State without using their facilities would go unhindered and they could have their short selling without let or hindrance?

Mr. ARON. I trust my position is not misunderstood. I do not favor any of the measures without further study. I have carefully refrained—at least, I am explaining my own theory, and admit that I do not know enough of the economics of short selling, nor do I believe any other body in this country does at the present moment, to act finally and intelligently regarding it.

Mr. McKeown. Is it the law in New York that I may not sell a certificate of stock or a share of stock which I do not now own but expect presently to buy and that is illegal? If I sell you a horse that I expect to buy on the market it is all right to sell you that horse.

Mr. Celler. In real estate in New York you can not sell a piece of property or real estate unless you own the property or have it under contract to buy, in which event you must state you have it under contract to purchase. But on personal property the law in New York State is quite different; personal property is quite different. You need not own, need not possess personal property, which, of course, includes stocks, to sell it.

Mr. Tucker. We are very much obliged to you, Mr. Aron. You have given us a great deal of valuable information.

Mr. Aron. It has been a pleasure to be here.

Supplemental Statement Submitted by Harold G. Aron, of New York City

At the suggestion of your chairman that I amplify my remarks on margin operations and the connection between margin and short sales, it may briefly be added that regardless of the merit or demerits of margin trading in stock purchases, there is no appealing reason for its use as an accessory to short selling. Collateral credit, for such is the essence of margin trading, may well be sought and given in stock transactions, as in any others, and there is no reason, economically or socially, why a bona fide purchaser should not get the credit, to which he is conservatively entitled, as when he buys any other kind of property. When, however, the short sale is involved, where the investment element is lacking and implicit in the vast majority of such transactions is the objective of a quick turn for a speculative profit, a different situation exists. There appears no argument why such transactions should be aided and abetted by credit facilities.

The vices of margin trading, in general, as it is actually carried on, are threefold: First, it encourages those who can least afford it to take risks with their limited capital; second, it impugns the integrity of all investment transactions and, finally, it renders practically impossible any dependable stability in securities markets. None of these is necessary if the purchase of securities on credit, that is on margin, is conducted with a decent regard to the interest of the purchasers and the public. None of these is avoidable if short-selling transactions are permitted to be financed on a margin basis. The basic danger lies in what may be termed wanton, reckless credit.

A conscientious broker will not let a customer buy more securities than he can carry under any reasonably to-be-foreseen contingency. Sound and intelligent investment bankers will not effect the distribution of securities on a preposterous or dangerous credit basis.

But there are brokers who will let customers go the limit, fixed only by the maximum of credit obtainable under the most favorable and frequently the most artificial conditions. There are investment houses and distributors who by high-pressure methods will, to effect a so-called sale, load up a customer by exhausting the credit possibilities of the transaction. The result is that the integrity of the investment market is frequently doubtful because of the unknown quantity of securities, supposedly sold, but actually oversold, to investors who will be "shaken out" of them by the slightest market disturbance or contraction of credit. In the active securities market, that is, of so-called listed securities, there is always a false bottom which gives way and destroys any stability of the market the moment a point is reached which loosens up and forces into the market securities held on too narrow a margin. To break this false bottom is the aim of every bear movement or attack. Now, these conditions destroy much of what would be the useful public service of stock exchanges and imperil the credit, business, and industry of the country. To use a military simile, the financial operations, conducted through stock exchanges encouraging or permitting such practices, are like an army frequently passing through narrow defiles and along precipices, where even the threat of an attack is apt to create panic. Such practices are unnecessary and can be eliminated

the moment there is any serious and sincere intention of stopping them; this can be done and best done by the stock exchanges and the banks catering for their business; it can also be done by legislation both simple and enforcable without creating any new legal machinery.

When it comes to the financing of short selling by permitting margin trading on the short side, there is no excuse for tolerating it.

To mention an apparently superficial reason first, it is this: If "short selling" were not so extremely simple in accomplishment, fewer transactions would be engaged in. It may be only the difference between raising a telephone and signing a check, but that difference would magnify into large effects, if every short transaction had to be separately treated and on a cash basis. A more obvious reason is this: If credit were denied, that is margin trading prohibited, on short-selling transactions, it would eliminate most of the "short selling" of the average stock-market investor. It would reduce the possible gains of the gamble by from 50 to 80 per cent, and take away the lottery characteristics, which are intrinsic in short selling on margin accounts. At the present time a man with a thousand dollars can sell short 200 shares of United States Steel. If it were a cash and not a credit transaction, if the customer initiating the transaction were compelled to supply his broker with the full amount of cash required to procure the necessary loan of the stock involved, his limit would be 20 shares. It is apparent how this simple measure alone would decrease the volume of short selling, leaving it only open to those qualified by fortune to avail of the short sale for economic reasons or in accord with so-called scientific investment principles. It could further save tens of thousands of "baby shorts" and novices from the most risky type of stock speculation; and it would minimize the menace to the public of organized "short selling" by reducing the reach or swing of the professional market speculators. To revert to our military simile, the investors who buy to have and to hold are the army which every once in a while is led through the defiles and along the precipices, made necessary to a degree by margin trading generally. Now, to permit the short-selling professionals to arm themselves with credit and increase their strength fivefold by the use of margin accounts, is to put machine guns in the hands of snipers and magazine rifles in the hands of guerrillas, to be used at the most critical time, when the army of legitimate investors are passing through defiles of deflation or along precipices of financial depression.

STATEMENT OF MR. JACKSON MARTINDELL, NEW YORK CITY

Mr. Martindell. Mr. Chairman and gentlemen of the committee, I am here this morning representing my own personal views and reflect in no way the opinion of my partners or clients in business. I have no antipathy or feelings toward the New York Stock Exchange or any of its members, the largest portion of whom are friends of mine.

Mr. Tarver. For the information of the committee, will the gentleman state who he is and whom he represents?

Mr. Martindell. As economist to the firm of Carter, Martindell & Co., investment advisors to financial institutions with assets of over $200,000,000, my experience indicates that margin trading and short selling were the chief causes of the major crises that have occurred since September, 1929.

Mr. Celler. Did you say margin trading?

Mr. Martindell. I say margin trading because margin trading is more tied up with short selling than the average experience investor realizes. I say that because I have traded in the market for many years on both sides of the market. I have traded successfully and I know that the greatest thing to be legislated against, and the thing which in my opinion does demand legislation, if we are to protect in a simple way the financial welfare of the people of this country, is margin trading.

Mr. Tucker. I suggest that we hear from the witness first.

Mr. MARTINDELL. I bring up margin trading knowing it is not mentioned in the bill and feeling it should be mentioned and feeling that there has been a lack of mentioning it because of the lack of information of what it means in connection with short selling. I say that because if there were no margin trading there would almost entirely be no stock to be borrowed. Therefore, there could be no short selling.

The most pronounced crises that were phases of the current bear market culminated on November 13, 1929, and October 5, 1931. Short-sale figures hitherto published do not give a true picture of the part that margin trading and short selling played in these two difficult periods, nor do they indicate the hand-in-hand connection between margin trading and short selling. In fact, the current discussion that has originated in Wall Street about short selling is intended to provide a smoke screen to hide the evils of margin trading which is the seat of most difficulty and abuse in the securities business.

Brokers should not be allowed to lend securities that belong to customers, but what is more important, they should not be permitted to lend money on securities. They should not be permitted to do a margin business. This margin business not only usurps a commercial banking function, but makes the vicious aspects of short selling possible. It is the brokers who lend stock to short sellers and they practically always lend stocks that are held on margin by clients. No commercial bank of reputable character would think of lending its customers' stock collateral. The fact that all reputable banks take this attitude should be proof enough as to the ethics of the thing.

It has been said within the last few months that the vast majority of the people who are on the short side of the market are not bear raiders. This is obviously so. Yet any individual who has intimate knowledge of stock market operations, as our organization has and must have in order to give competent advice, should realize that bear raiding has at times been a considerable part of stock-market gyrations within the last two years. It has been pointed out that "in and out" short sales on the stock exchange have never exceeded 10.41 per cent of the total daily sales. This does not prove anything. Any broker knows that the sale of only 1,000 shares of stock at the right time and price can uncover actual selling orders of many times that figure. Therefore it is not difficult to see that short selling on an "in and out" day basis of only 5 per cent of total transactions could play havoc with the credit structure.

It is not reasonable to safeguard the credit structure of the banks and let the credit structure existing in brokers' offices be undermined. Either eliminate or protect the latter, is the common-sense attitude.

One of the greatest evils of short selling is the extent to which large short positions tempt individuals and syndicates to spread rumors that could very easily lead to disaster. As a matter of fact, a comparison of bad rumors afloat and shares of stock on loan for short account, would reveal interesting figures. It is now possible for large organizations, which through their great resources and importance can sway the market, to take short positions on an extended scale and make large profits at public disadvantage.

The only legitimate pretense to the justifiableness of short selling lies in the fact that a cushion of demand is sometimes provided whereas it might otherwise be almost entirely lacking. This is quite naturally the case at present, but it is not sufficient justification of short selling as it is now practiced. Only a minority of stocks on the stock exchange ever have any amount of short interest and yet, despite a lack of short interest, they seem to attract buyers if they have merit, even during times of stress. On the other hand, the published figures of the stock exchange indicate a normally large short interest in Bethlehem Steel, for example, and yet there were times last fall when bids were notoriously lacking.

The stocks that have the largest short interest usually have the best market, but this is not cause and effect. Far from it. General Motors has a large short interest because the stock is easy to borrow, yet it has a good market because it is well thought of by investors the world over. Who would dare suggest that the only buyers for General Motors on any particular day come from those who are short the issue? If securities are good, and the issues are large, then they have good markets regardless of short positions.

United States Government bonds have the best markets of all, yet it does not take a short interest to make this true. Bank stocks have good markets, yet, who borrows bank stocks to sell them? Ask any banker why he would not like to see short selling in his stock issue and he will tell you that short selling—on an extended scale as now practiced and not on future contracts—is more likely to precipitate additional selling than provide stability.

Every banker knows that in 1929 the money market was beyond actual control of the Federal reserve system. The astute bankers know that this lack of control was due to the fact that the brokers are allowed to conduct a margin business. It works this way. Margin business conducted by brokers provides call-loan market. This call-loan market reached a peak of $8,549,000,000 in 1929. Banks, corporations, and individuals were pouring money into the call-loan market (all to support margin trading) because the rates that could be secured on call money were more attractive than rates that could be secured in the commercial market, namely, the purchase of bank acceptances. The only brake available by the Federal reserve was to raise money rates by selling Government securities or increase the rediscount rate. The Federal reserve knew then, as it does now, that either action places a penalty on legitimate business in that it makes scarce the supply of money for commercial transactions.

It is just as important that brokerage houses be under the supervision of banking departments as it is for the banks; that is, unless the brokerage business is divorced from the collateral-loan business. At the peak of the bull market, brokers' loans stood at the stupendous figure of $8,549,000,000, while all member banks of the Federal reserve system reported peak loans to customers on security collateral of $9,179,000,000. In other words, brokers' loans were almost as large as customers'-collateral loans at all Federal reserve member banks, and yet there was no effective supervision covering this tremendous sum of credit.

This lack of supervision resulted in stock-market liquidation as measured by a 91 per cent decline in brokers' loans to $730,000,000

the first day of December, 1931, while security-collateral loans at member banks had declined less than 37 per cent to $5,807,000,000. This indicates a credit weakness in that brokerage customers have been forced out of their position with great dispatch and without regard to their personal credit standing in the community.

The thing to visualize is the fact that the individuals who have actually been separated from their securities in the last two years, without regard to their particular desires, have largely been those borrowing money from brokers, and likewise those whose stocks have been used to help short sellers complete their transactions. These figures are irrefutable and the conclusions drawn can not be denied.

People do not comprehend the immense influence which brokers have in financial matters and the little effort made by many brokers to measure up to their responsibilities. This may be because the law does not recognize the broker's responsibility or his power for good or destruction. A hundred times as much damage may be done yearly through ill-advised action by legitimate brokers as is wrought by all the blue-sky stock salesmen in the world.

It is generally contended that any business man should have the right to hedge his inventory, whether it be stocks, commodities, or whatnot, by taking a short position as a hedge. This is sound reasoning and hedges can be effected in most commodity markets by selling futures. The same is even now true in the stock and bond markets as stock exchange rules provide for sales and deliveries in 3, 7, 10, 30, and 60-day contracts. Should anyone desire to effect a hedge against his security inventory he can do so through these sellers' contracts, thereby eliminating the necessity of borrowing stocks from some unfortunate and uninformed margin speculator.

The reason why future contracts are not used to greater extent in the securities market is because it is too easy to sell a security and make delivery through borrowing, without disclosing the fact that a short sale has been consummated.

As matters now stand the buyer is not even given the privilege of knowing whether he is buying something that a man does or does not own. While it may be said that he gets exactly the same type of certificate, it is obvious at times that any right-thinking person would want to know whether or not his purchase was of public benefit or merely aiding a short seller to make a profit.

Brokers have their customers sign legal documents giving the broker, among other things, full authority to lend the clients' securities, but few clients ever know this clause is in the contract, nor is any client offered the opportunity of opening a brokerage account on a margin basis without this clause in the contract. Few of those who know the power they are giving to the broker realize the significance or the possibilities of it.

Even now, without any laws to restrict them, many of the more reputable stock exchange houses will not accept margin accounts and will not lend their customers' securities to anyone. This is not any new procedure, because many houses have done business on this basis for years.

I have outlined here the advantages and disadvantages of margin trading and short selling. I group the two together because they go hand in hand.

As to the advantages, I would say it increases the volume of trading, thereby narrowing the bid and asked prices. It increases the broker's profits and it increases the value of stock exchange membership.

Mr. OLIVER. How many kinds of short selling have we got on the market? There is the sale against the box. That is one kind.

Mr. MARTINDELL. That is hedging.

Mr. OLIVER. That is short selling?

Mr. MARTINDELL. That is short selling in a sense, but it can be used, not through the method of borrowing securities. As a matter of principle, I will says there are two types of selling securities. There is sale under contract such as now practiced on the commodity market, as now practiced on the New York Stock Exchange, although not very frequently because the rules of the stock exchange give you permission to sell on 3, 7, 10, 30, and 60 day contracts. That is why you could sell 100 shares of any particular stock on a call quotation appearing on the stock exchange ticker, anticipating such a transaction, indicating to other people that you have a contract for short sale which will be protected. It is public information. That can be used to-day and that is one type of short selling. The other type of short selling is to sell 100 shares or 10,000 shares or any number of shares you can borrow from a margin account, and that is not at that particular moment his security.

Mr. TUCKER. And perhaps he doesn't know?

Mr. MARTINDELL. That is true.

Mr. OLIVER. I did not hear the short selling described in time.

Mr. MARTINDELL. On the side of the distadvantages, I would say there are disadvantages because it permits squeezing of shorts, which has a disturbing effect on the entire market, and it makes possible the "gunning" for weakly margined accounts; it increases speculation and decreases investment. It quickens the rapidity of decline in bear markets, which adds greater strain to banks. It helps to create bad rumors. It creates the evils of the call-loan market. I will enlarge on those different questions later.

Too much stress is being put upon the question of whether short selling has been the most important factor in the current market decline. This is beside the point. There is no doubt in any experienced market operator's mind that stocks would have fallen in price and probably to just as low levels without the impetus of short selling, but this is no justification of existing market procedure. Without short selling and margin trading, stocks would never in the world have sold so high in the first place, therefore the extent of decline would have been much less.

If a detailed study is made of the various sharp reactions of the stock market approaching in character to what we might call a crisis, bringing great stress to bear on our banking structure, this study would undoubtedly reveal that the reactions have been preceded by and caused in large measure by the action of one or two particular stocks. For instance, in the last pronounced market decline that culminated on December 17, 1931, New York Central common stock was, in our opinion, the one security that caused sufficient stock market uncertainty to bring about the severity of the collapse in

general security prices that occurred. New York Central harbored the largest short interest that ever existed in the issue.

The published short account figures covering the entire stock list are meaningless. They give no indication of the tremendous influence that in and out day trading by shorts on the floor of the stock exchange have had on stock prices. The stock market during times of financial stress may be compared to a snowball rolling down hill. Every little push that a short trader gives this snowball is far more important than any mere statistical tabulation can possibly indicate. We know this to be true because it has been our experience that during such times as this the sale of only a few thousand shares of any issue of long stock by our customers has had a marked influence on sentiment.

Even those figures showing actual short accounts in various stocks at various dates must be correctly interpreted. Of the 1,281 securities listed on the stock exchange, less than 25 have market significance from a technical standpoint. For instance, American Radiator & Standard Sanitary Corporation has 10,158,127 shares of common stock outstanding and yet the short position in this stock as of November 30, last, was less than 5,000 shares. Including such issues as this in a short position tabulation makes it possible to show the total short interest at any time to be only a very small percentage of the total shares listed. Yet on the other hand, American Radiator has a much better market than a great many issues that have an overextended short position.

The following stocks are more to be considered as the ones whose actions have technical significance, and this list, of only 20 out of a total of 1,281 issues harbored 60 per cent of the entire November 30 last, short interest of 3,745,642 shares as indicated below:

Name	Short interest Nov. 30, 1931
American Telephone & Telegraph	169,012
American Can	137,268
Anaconda Copper Mining Co	61,830
Bethlehem Steel	107,175
Case, J. I. (threshing)	73,843
Du Pont de Nemours	108,271
Auburn Auto	51,301
General Electric	204,064
United States Steel	332,387
Westinghouse	83,145
Radio Corporation	48,795
Electric Power & Light	36,605
International Telephone & Telegraph	48,850
Woolworth Co	55,051
United Corporation	66,924
North American	108,140
Consolidated Gas	61,329
American & Foreign Power	56,447
Allied Chemical & Dye Corporation	68,543
General Motors	401,304
Total shares	2,280,284

It is claimed by many investment houses that when they originate a new issue, they must take a short position in order to effectively market and distribute their securities. There is some basis of truth in this, but the short position can be covered by a when-issued basis of trading which does not require the borrowing of any securities.

It is also said that short selling helps to prevent various stocks being marked up to fictitious levels. As a matter of fact, our experience of many years does not lead us to this conclusion. Nearly always we look for runaway markets and fictitious prices in those very securities which harbor the greatest proportion of short interest to capitalization. It is a process of squeezing the short interest that almost always makes stock sell at forty to fifty times their earning power when they should be selling at one-fifth this price.

Many of the fictitious bull market rises in such issues as Simmons Co, Auburn Automobile, J. I. Case, Westinghouse Electric & Manufacturing, and so forth, were undoubtedly the direct result of squeezing shorts at least in part. Instead of short selling having the effect of preventing runaway markets, it is nearly always the direct cause of them.

Hedge selling in itself is not the thing that demands legislation. It should be allowed in all markets, but under laws and regulations prohibiting the lending of securities or short selling in all instances, and the lending of money on securities except by recognized banking institutions that are supervised by law as such. Banks could be depended upon to more intelligently handle security loans without competition, because they have more experience and ability in the lending of money, and they do not stand to profit through brokerage commissions on the active purchase and sale of securities. It is the investment banker's duty to originate securities, the broker's duty to execute buying and selling orders in them after they have been originated, the commercial bank's duty to lend money on them, and the investment counsel's duty to render advice to the institutions and the public concerning these activities.

Mr. TUCKER. You have given us your paper, which seems to be a very elaborate paper as to the things you touch upon and you say there is no such thing before the committee.

Mr. CELLER. May we have Mr. Martindell back again so that we can ask some questions of him?

Mr. TUCKER. Mr. Perkins, of New York, will testify Wednesday, and also a professor from the Wharton School of Finance. We are very much obliged to you, Mr. Martindell.

Mr. SABATH. May I ask, in view of the fact that these two gentlemen will take up all day Wednesday, if you can hear several gentlemen whom I have here who are authorities on this subject?

Mr. MICHENER. The committee in executive session determined that Mr. LaGuardia, who has one of the bills and is a member of the subcommittee, should arrange the order of the hearings and we have heard these witnesses to-day. If the gentleman has additional witnesses I suggest that you take it up with Mr. LaGuardia.

Mr. SABATH. That will be satisfactory.

(Thereupon, at 11.55 o'clock a. m., the committee adjourned to meet again at 10 o'clock a. m. Wednesday, February 17, 1932.)

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE No. 3, COMMITTEE ON THE JUDICIARY,
Wednesday, February 17, 1932.

The committee met at 10 o'clock a. m., Hon. Henry St. George Tucker (chairman) presiding.

Mr. TUCKER. The committee will be in order. We have with us to-day three gentlemen, who will be heard in the following order: Mr. William R. Perkins, of New York, first; Mr. Huebner, of the Wharton School of Finance, University of Pennsylvania, Philadelphia, second; and Mr. Albert S. Brown, of Boston, third.

Mr. Perkins, the committee will be glad to hear you now.

STATEMENT OF WILLIAM R. PERKINS, ATTORNEY AT LAW, NEW YORK CITY

Mr. LAGUARDIA. Will you give your name and address to the stenographer for the record?

Mr. PERKINS. William R. Perkins, 535 Fifth Avenue, New York.

Mr. LAGUARDIA. You are a lawyer?

Mr. PERKINS. Yes, sir.

Mr. Chairman and gentlemen of the committee, a short seller has been defined by those who uphold short selling as a man who "has become convinced that a certain security is selling at too high a price. He feels that it is certain to sell at a lower price in the future and he wishes to take advantage of this situation."

Starting with that definition, we find that short selling is widely disinguished from all other selling by the following characteristics which should be clearly apprehended and definitely borne in mind:

First, the sole motive of a short sale is the hope of a profit from an expected decline in the market value of the thing sold. Without this hope the sale would not occur.

Second, the sole opportunity to make this desired profit comes through a decline in the market value of the thing sold. The commitment of the short seller to repurchase the thing sold forbids any other source of profit and will occasion a loss if the market value rises.

Third, the endeavor, therefore, is to sell at a time and in a manner most calculated to secure the desired decline in market value. The motive of the sale makes this a compelling temptation. Short selling is the best known way for creating calamity howlers.

Fourth, the endeavor is also, therefore, to repurchase at a time and in a manner least likely to restore the market value decline and undo the desired profit. The motive of the sale makes this too a compelling temptation. The short seller ardently wishes to compress that vaunted cushion into the very skimpiest proportions.

Fifth, the weapon used by the short seller is about the best the wit of man could devise to accomplish his purpose. It is a secret, artificial inflation of the selling-supply to overbalance the buying-demand and bring declining prices in accordance with the well-known effects of the law of supply and demand.

No other sale has such a motive, requires such an opportunity, offers such a temptation, or creates such an inflation, whether of a crop to be grown, a product to be made, or a house to be erected. In all other sales the seller makes his profits in the sale, without any regard to repurchase, and wishes his customer all the luck in the world with the thing sold. It remains for the short seller alone to seek his profit from a loss to the purchaser, to require a victim whom he must put in a hole and keep there until the desired reward can be obtained.

These characteristics throw into its true perspective the stock exchange thesis that short selling checks a rising market and supports a falling one; or, as stated by Mr. Theodore Prince, a prominent broker, in a newspaper interview he is now circulating: "Short selling adds to the number of sellers in a bull market and adds to the number of buyers in a bear market"—words which fall on the ear with a strange inconsistency when we consider the real purpose of a short sale and the sole way in which that purpose may be achieved.

I wrote to Mr. Prince, asking him:

> Why, in discussing short selling, do you mention its addition to sellers only in connection with a bull market and speak only of its addition to the number of buyers when you refer to a bear market?
>
> Can it not, with equal truth, be said that "short selling adds to the number of sellers in a bear market and adds to the number of buyers in a bull market," with the consequence that the act of selling short will expedite "rapidly declining prices in a bear market" for the same reason that it will, as you say, "tend to check an over-extended bull market"?

And should we not on that account—

> Recognize that short selling does increase the decline of prices on a falling market by the additional selling it creates, and that such short selling is made for the purpose of producing the decline because the short sellers are actuated, not by pro bono publico motives but in order to make a profit for themselves?

Mr. Prince replied, saying:

> I have read your letter with interest and, of course, can not deny what you say about the temporary effect of short selling; but that is only part of the factors which increase the supply. There are many others, such as earnings, confidence, investment, etc. * * * The subject is broad and, personally, I am committed to the opinion that short selling does not depress prices. Naturally there are thousands of other factors that cause prices to decline. It is my opinion that short selling has a sound economic basis.

That is what Mr. Prince says.

I quote this correspondence because it first admits the depressing effect of short selling and then accentuates the fallacy of those supporting short selling by failing to make the palpable distinction between a natural cause of decline, like lowered earnings and an artificial one like speculative short selling, as well as by ignoring the urgent practical consideration that short selling because of its artificiality lends itself easily to most serious abuse through the controlling element, personal profit.

If stock exchanges could be governed by some all-wise and uncontrolled being who, without possibility of gain or loss to himself, could in total disinterestedness sell when he thought a stock too high and repurchase when he thought it too low, we would measurably approach that idyllic state when the thesis would be a formula for good instead of a philosophic platitude. But the characteristics of short selling unfortunately compel the belief that it is not an altruistic or philanthropic practice but a cold, hard business for money making in the way and by means I have described. And the amount of commissions from short selling makes not only the members, but even the officials, of an exchange interested in a continuance of the practice, even if they are not short sellers themselves. They are members of firms who profit by these commissions and the other perquisites of short selling.

The remarks in 1905 of the now venerable and always greatly respected Mr. Justice Holmes are perhaps those most frequently quoted in support of the thesis. Speaking of commodities he said in the case of Chicago Board of Trade *v.* Christie (198 U. S. 236, 247–8):

> Of course, in a modern market, contracts are not confined to sales for immediate delivery. People will endeavor to forecast the future, and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want. It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such course attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain.

Subsequently, however, Congress investigated the selling of commodities on boards of trade and uncovered such a situation that it passed in 1922 the grain futures act, in which it declared:

> That the transactions and prices of grain on such boards of trade are susceptible to speculation, manipulation, and control, and sudden or unreasonable fluctuations, in the prices thereof frequently occur as a result of such speculation, manipulation, or control, which are detrimental to the producer or the consumer and the persons handling grain and products and by-products thereof in interstate commerce, and that such fluctuations in prices are an obstruction to and a burden upon interstate commerce in grain and the products and by-products thereof and render regulation imperative for the protection of such commerce and the national public interest therein.

Still later, this act was attacked in the courts as unconstitutional. Among the proofs offered were "opinions of many professors of political economy in the colleges of the country to the effect that trading in futures in the long run did not depress prices, but stabilized them." After full inquiry and argument, the act was broadly sustained by the Supreme Court of the United States, with the concurrence of Mr. Justice Holmes, in an opinion by Chief Justice Taft in which he said (Board of Trade v. Olson, 262 U. S. 1, 37–40):

> It is clear from the citations in the statement of the case, of evidence before committees of investigation as to manipulations of the futures market and their effect, that we would be unwarranted in rejecting the finding of Congress as unreasonable, and that, in our inquiry as to the validity of this legislation, we must accept the view that such manipulation does work to the detriment of producers, consumers, shippers, and legitimate dealers in interstate commerce in grain, and that it is a real abuse.
>
> * * * Manipulations of grain futures for speculative profit, though not carried to the extent of a corner or complete monopoly, exert a vicious influence and produce abnormal and disturbing temporary fluctuations of prices that are not responsive to actual supply and demand, and discourage not only this justifiable hedging, but disturb the normal flow of actual consignments. A futures market lends itself to such manipulation much more readily than a cash market.

Such an investigation, which undoubtedly should be made, will disclose the very same situation in the security market and give the very same answer to the similar statements about the short selling of securities made by the Highes Commission and certain economists, such as Professor Boyle of Cornell—and for the very same reason. Wherever he appears, the short seller is an opportunist, dominated by the greed for gain. Even into 1932, the bear tactics have continued. The New York Stock Exchange figures showed an increase

in the overnight short interest in January, 1932, of 758,193 shares, nearly all during the latter half of the month, which again carried market values down, despite its self-imposed restrictions on short selling.

Under the impulse of measures to stop the forces of destruction, such as the Reconstruction Corporation, broader banking laws and an antihoarding campaign, we are now seeing a retreat of the bears and a consequent spasmodic upturn in values. But whether it will amount to anything more than occurred last summer when the moratorium was announced is altogether problematical, unless there be legislative regulation of short selling.

The short seller's motives makes him pick for his sale the time he thinks most propitious for a market value decline. If the stock exchanges wish the public to believe that more short selling occurred during the bull market which culminated in the fall of 1929, when short selling might have checked a rising market, than during the subsequent bear market, when the prospect of market value decline made rosy the promise of large profits from short selling, let them produce the figures. I make this challenge, feeling sure it will prove a comparison most odious in their eyes—the occasion for as much explanation as the suspension of short selling (when Great Britain abandoned the gold standard) in order to coerce the bears and prevent their taking advantage of that grave situation.

For this reason also the short seller directs his efforts at those stocks which he thinks most likely to bring about the market decline he desires. Just here is where general statements fail to inform properly, such as that the total short interest is only a small percentage of the total shares listed or sold or that the average short account is small. On the stock markets, as elsewhere, leadership controls. Short selling is largely done by bear leaders and market values respond to the rise and fall of key stocks known as market leaders.

I have prepared a Schedule A, which I will submit for the record, which shows that 20 leading stocks carried the bulk of the overnight short interest in 1931, namely, 51 per cent on May 25, 54 per cent on July 3, 59 per cent on September 11, 59 per cent on October 5, and 61 per cent on November 30.

Mr. CELLER. Will you just name some of those stocks?

Mr. PERKINS. I have a schedule of them here.

Mr. CELLER. Well, I want to ask you a question about them.

Mr. PERKINS. May I show that later? I have a schedule here showing that.

Mr. CELLER. Does it show all the names?

Mr. PERKINS. It shows all the names and the figures.

I have prepared a further schedule, Schedule B, which I will also submit for the record, which shows that in 1931 a group of 50 well-known stocks carried 69 per cent of the overnight short interest on May 25, 70 per cent on July 3, 75 per cent on September 11, 76 per cent on October 5, and 80 per cent on November 30. As the stock issues with a short interest numbered 616 on May 25, 597 on July 3, 517 on September 11, 450 on October 5, and 556 on November 30, this means that as an average on those dates less than 4 per cent of these stock issues carried from 51 per cent to 61 per cent of the overnight short interest and less than 10 per cent of these stock issues carried from 69 to 80 per cent of the overnight short interest.

Mr. CELLER. What is meant by the "overnight short interest"?

Mr. PERKINS. It means excluding the "daily in and out," and "selling against the box."

Mr. CELLER. That is, the "daily in and out"——

Mr. PERKINS (interposing). By a purchase and sale——

Mr. CELLER (continuing). By a purchase and sale the same day?

Mr. PERKINS. A purchase and sale the same day.

Mr. CELLER. That is not included in your figures?

Mr. PERKINS. That is not included in my figures.

Mr. CELLER. And you say "selling against the box" is not included in those figures?

Mr. PERKINS. "Selling against the box" is not included in those figures.

If we could get the names and amounts of the 12,254 short-selling accounts which Mr. Whitney, the president of the New York Stock Exchange, tells us averaged less than 300 short shares apiece, I have no doubt we should find a similar situation regarding them; certainly, this account information would be most illuminating.

Likewise for this motive we have the bear raiding methods used by short sellers to cause and keep a decline in market values so that they can reap their profit. They include tactics in the actual short selling on the exchange floor and propaganda for the public in order to bring forced and scared liquidation, by a break of morale and prices, in which the short seller may cover profitably.

Bear raiding tactics on the exchange floor were denied by Mr. Whitney in his Hartford address. But the exchange admitted the existence of one form of bear raiding when it prohibited 100-lot short sales at less than the preceding long sale. It is said, however, that this prohibition is being circumvented by sales through odd-lot houses and the expedient of keeping sufficient shares on hand to make at successively lower prices long sales to be immediately followed by the desired short sales.

Bear propaganda in 1931 was prodigious. It took almost every conceivable form, dire predictions, vague forebodings and mysterious rumors, with which all are only too familiar. No stock escaped recurrent prognostications of impaired earnings and reduced or omitted dividends which spread a miasma of gloom that was paralyzing. For you can make even a well man sick by constantly telling him that he looks badly. Consider a copyrighted article headed "Tobacco tax threat looms," which appeared in the New York afternoon papers on December 16. It calalogued the woes of the tobacco trade, quoted a prominent brokerage firm as prophesying, for reasons stated, that the tobacco companies would be much less profitable in the future than they had been in the past, stated that "in recent months renewed general liquidation" of these securities had carried them "to the lowest price levels they had touched in years." The effect on tobacco shares was, of course, tremendous. American Tobacco B fell 6 points on the next day to its year's low of 64. And when the short selling statistics came out it was found that this article had appeared when the short selling burden carried by tobacco stocks was about at its peak.

There have also been ugly and persistent intimations of specialists making known to short sellers for their guidance the confidential

buy and sell orders on the specialists' books; of short sellers obtaining from brokers and bankers knowledge of the shares carried on margin——

Mr. CELLER (interposing). Did you say that specialists have made those rumors?

Mr. PERKINS. I say they have done this——

Mr. CELLER (interposing). Did you say rumors that specialists had indulged in rumors?

Mr. PERKINS. No; I say rumors of specialists having made known the contents of their books; and intimations of short sellers obtaining from brokers and bankers knowledge of the shares carried on margin or in collateral which created vulnerable situations; of high officials having sold short the stock of their corporations on their confidential advance information as to their affairs so that an exposure would be most disconcerting and disillusioning.

A case in point seems to be Radio-Keith-Orpheum class A shares. On October 2, 1931, the price was $8 and the short interest 5,200 shares. By November 5, 1931, the short interest had increased to 148,852 shares with a $6 price. Thereafter a financing plan was announced, later a receiver was asked, and on December 21 the price was 75 cents. Manifestly, the short sellers had information denied not only to the public who might buy, but even to the stockholders themselves, until the collapse.

Lest some may think I am giving rein to my fancy, I quote at length from a lucid article in the Financial World for January 6, 1932, entitled "The Truth About Short Selling," by an ex-member of the New York Stock Exchange who speaks from his own knowledge and experience, as to what happened in former panics.

Mr. CELLER. What is his name?

Mr. PERKINS. I do not know. It does not give his name. I suppose the editor can give you his name. This man says:

> One of my early experiences was in the 1906 boom just before the 1907 panic. Great Northern preferred had been rising until the price had reached figures quite as absurd as anything in the recent boom. At 250 I began selling it short in a small way, each time covering at a loss. Fortunately I had a friend who was an old and successful trader (one of the few I have known to make large sums on the short side and keep them). He called me aside one day and said: "Look here, young fellow, quit trying to pick the top of this market or you'll go broke. Wait until the market is definitely over the top and 20 points down on the other side; then sell them, and you'll have everybody else selling with you." That is the secret of successful short trading. I might add that Great Northern preferred sold at 348 before starting down.
>
> The "astute traders" of the economists don't fight the market trend and act as a brake at the top. They wait until it is well over the top, then they get behind and push it down as far and as fast as they can.
>
> Short selling without liquidation would, of course, get nowhere. After every period of excessive speculative activity, there is bound to be liquidation until that excess is corrected. But undoubtedly the driving of a bold and determined bear clique carries liquidation beyond normal and causes unnecessary distress and loss to many. Much liquidation would never be brought out except for these bear attacks.
>
> Purchases by shorts have little more than a temporary effect, as their buying is not new buying. They simply turn over the stock purchased to the man from whom they have borrowed it, increasing his liabilities accordingly.
>
> If a bear wishes to sell, say, 20,000 shares of short stock, he goes in and sells 10,000 shares as carefully as a long would. Then he waits until he finds a moment when buying orders in that stock are few, perhaps some day just before the close, when he will send in several brokers each with orders to sell "at the market" and fairly hurl his second 10,000 shares at the market. This causes a sharp break and brings in frightened selling and perhaps the closing

out of some exhausted margin accounts. If his selling brings in the expected liquidation, he will probably cover all or part of the last 10,000 shares and await an opportunity to repeat the operation. Thus he is constantly marking down his main line of stock and making excellent trading profits. If he is a large operator, he will employ some carefully selected propagandist to circulate all sorts of rumors, true and false. Even without a propagandist, if he can drive a stock down spectacularly, Wall Street itself will manufacture rumors galore. It is one of the evils of Wall Street speculation that these rumors crop up from all sorts of unknown sources in both bull and bear markets and mislead a great many innocent people.

To give a further idea of the methods of short sellers, when the war boom of 1916 reached its peak one of our cleverest operators became very bearish on United States Steel. For weeks he sat in his broker's office doing nothing. Then one day he gave an order to sell 5,000 shares of Steel at the market. Before his reports were in, he gave an order to buy 5,000 shares at the market. This was repeated nine times. Each time the market failed to give way under his selling, and he immediately covered. The tenth time the market action suited him and he immediately gave an order to sell another 10,000 at the market, then 10,000 more, and at the congressional investigation it developed that he was short a huge amount. He made a killing, but he didn't fight the market trend, nor did his selling and repurchasing help to cushion the market. It furnished a very important part of the motive power for the decline.

Everyone who knows his way around below Fulton Street knows that "bear raiding" has always been an accompaniment of every period of liquidation. During one bear market, when the writer was a member of the stock exchange, a group of powerful floor traders went about the room day after day looking for stocks in which there was weak support. Whenever they found one, they would promptly fill up the specialist's book and then trade furiously back and forth between themselves, always on a downward trend, and often succeeded in knocking $2 to $5 off the price in a short time, making a nice profit on their original sale of four or five thousand shares. Thus on trading in which there was a change of ownership of a few thousand shares, they established the price of an entire issue of several hundred thousand shares, and affected every bank loan and margin account in which there happened to be any of this stock. In this way, prices were hammered down day after day, and more and more forced liquidation brought out.

There is another phase of bear raiding, as to the moral turpitude of which there can be no question. In at least one instance in this bear market the bear raiders knew of a big loan, secured by a large block of stock of one of our premier corporations, which would be called if they could drive the price of that stock to a certain figure. This they immediately did, causing cruel loss to the man who had made the loan. How did they get this information, through some underling in the back or did it come from an officer or director? A stockholder and prominent director of one of our largest banks is commonly reputed to have been intimately associated with the big bear crowd.

This brings me to the artificial inflation of selling-supply caused by short selling, which I have said is about the most effective weapon to produce market value decline that the wit of man could well devise.

When a corporation wishes to increase its outstanding shares there must be careful compliance with both the corporate and blue sky laws which have been enacted to safeguard stockholders and the public. There must be proper authorization by charter and resolutions; these must adequately protect both the corporation and its shareholders, and due publicity must be given by filing and notification. All these things are required to be done openly, advisedly, fairly, because of the well-known effect such an increase has on the value of existing shares and the rights of existing shareholders.

Not so, however, with the short-selling method of increase. The short seller sells what he does not own and makes delivery from the "floating supply" of shares created by the exchanges for that purpose through the requirement that members may lend to short sellers all shares carried on margin for customers. The transaction

makes the purchaser the owner of shares in the corporation, but does not make the customer whose shares are lent cease to be such an owner. So short selling increases the sold shares of a corporation to the extent of the short interest. And as the purchaser may carry his shares on margin so that upon his purchase they go back into the floating supply, this floating supply becomes a reservoir or revolving fund of shares for the short selling of many more shares than may be in the floating supply at any one time.

You will thus perceive that short selling is a secret increase of the sold shares of a corporation, without any limit but the willingness of the short seller to sell short and his abiity to borrow shares for that purpose. And you thus realize what a mighty engine for destruction of market values short selling is through its artificial magnification of selling supply to overbalance buying demand.

For example, the J. I. Case Co. has 195,000 shares outstanding; yet the sales of this stock aggregated 13,777,300 shares in 1931, and on August 28 the short interest was 139,600 shares, which means that on that date the selling supply had in this way been inflated to 334,600 shares. The sales of these shares for the one day, February 8, 1932, totaled 71,600 and the stock fell to a new low of $27⅛. This is an extreme case, of course, but one which makes plain what I mean and the potent power for value destruction in short selling, which has thus become the modern substitute for the famed printing press of bygone days.

Mr. Whitney, the president of the New York Stock Exchange, said in his Syracuse address:

> Let me repeat that the fundamental economic law of supply and demand will ultimately cure any unsound tendencies. The sound relation between speculation for declining prices and speculation for advancing prices will only come about if the law of supply and demand is permitted to work freely and naturally. If we attempt to interfere and to impose artificial restrictions upon either the purchase or seller of securities we are bound to create an abnormal and unnatural market which will ultimately bring about worse evils than those we seek to cure.

That is what Mr. Whitney says.

I agree with that statement whole-heartedly. I want no artificiality. I believe unsound tendencies will be established "if the law of supply and demand is permitted to work freely and naturally." It is just for that reason that I wish a curb placed on the artificial inflation of selling supply by short selling which so upsets the free and natural working of the law of supply and demand. Those who defend short selling themselves make this very distinction when they say that liquidation, not short selling, has caused the decline. What is that but an attempted differentiation between real selling and the artificial short selling which has created just the "abnormal and unnatural market" Mr. Whitney advises us to avoid?

Surely, when our corporate and blue sky laws so hedge about an increase of sold shares by the corporation and its officials it is not asking too much that some tantamount safeguard be thrown around an increase in sold shares by short selling. Overproduction in securities has the same effect, in the same way and for the same reasons, as overproduction in other things. Declining prices are the penalty. That penalty has been paid supremely by our securities. And the pity of it is that, whereas overproduction by field and factory is to give employment and supply useful articles, in the stock market it is

a wholly artificial inflation for the express purpose of destroying values.

By this I do not claim—no one claims, so far as I know—that real liquidation, forced, scared, or voluntary, has not constituted the bulk of the selling. What I do claim is——

Mr. CELLER (interposing). Will you repeat that last statement? I did not hear that.

Mr. PERKINS. By this I do not claim—no one claims, so far as I know—that real liquidation, forced, scared, or voluntary, has not constituted the bulk of the selling. What I do claim is that short selling has been a major producing cause of this liquidation. The very purpose of short selling is to start such an avalanche of liquidation that the repurchase may be made when it occurs without restoration of market value; and short selling accomplishes this by skillfully and relentlessly forcing down market values until margins are exhausted in banks and with brokers and forced selling abounds, which brings lower prices that dry up values and cause more selling—the real breaks we have witnessed.

The statistics amply confirm such domination of the 1931 market by short selling. During March, April, and May, 1931, there was progressive aggregate decrease of $14,520,780,805 in the stocks listed on the New York Stock Exchange alone, while the short interest in them was reaching a peak of 5,589,700 shares on May 25; in June, 1931, these market values increased $4,883,161,905, while the short interest decreased 1,955,439 shares; the short interest then increased to 4,374,200 shares on August 7, while these market values decreased $2,994,407,135; the short interest further increased to 4,480,400 shares on September 11, when the market collapsed, so that there occurred a decrease in these market values of $12,259,988,669 in September, notwithstanding the short interest decreased to 3,036,928 shares on September 30.

Taking the figures given in New York Stock Exchange Bulletin, volume III, No. 1, and illustrated by a graph on page 19 of that number, we find, for the year 1931, that on May 25 the total short interest was 5,589,700 shares and the daily stock price index stood at 106.4; on July 3 the total short interest had declined to 3,634,261 shares and the daily stock price index had risen to 121.2; by August 7 the total short interest had risen to 4,374,200 shares and the daily stock price index had fallen to 108.1; by September 11 the total short interest had still further increased to 4,480,400 shares and the daily stock price index had fallen further to 100.8. Under this the market then broke, so that although the short interest had declined to 2,612,414 shares on October 5 the daily stock price index had declined to 70 on that date.

Following this came a period during which short selling seems to have abated somewhat, so that on November 9 the daily stock price index stood at 91.5 while the short interest was 2,897,874 shares. By December 10, however, the short interest had again risen until it stood at 3,767,236 shares and the daily stock price index had declined until it sood at 68.1. This again broke the market, so that although the short interest had declined to 2,842,072 shares on December 31 the daily stock price index stood at 64.5 on that date.

You will get even more clearly the great burden of short selling when I tell you that during the part of 1931 covered by the exchange

statistics the average daily overnight short interest alone much exceeded the average daily sales, and in January, 1932, this average daily overnight short interest was double the average daily sales. What could withstand such inflated selling pressure?

Coming to particular stocks, we take first General Motors, because Mr. Whitney, in his Syracuse address, cited this as one which specifically confirmed his contention that if "short selling smashes prices then certainly one would expect the stocks with the largest short interest to show the widest fluctuations and the greatest declines." For, said he:

> The greatest short interest in any single stock at any time was 406,000 shares in General Motors, which has 43,500,000 shares outstanding, making the short interest actually less than 1 per cent thereof, and the market action of General Motors has been consistently steady. Great quantities of the stock have been bought and sold and yet it has normally moved by small degrees either upward or downward.

Quite different, however, was Mr. Whitney's statement, in his Hartford address, in describing what occurred on September 21, 1932, when short selling was forbidden and the short interest in General Motors was considerably less than 406,000 shares. I find that he then said:

> Within two hours after short selling was forbidden, the governing committee found there was a real danger of technical corners and of crazy and dangerous price advances. At one time there were accumulated orders to buy approximately 8,000 shares of General Motors stock at the market——

Mr. CELLER (interposing). Was this the time that they prohibited short selling on the New York Stock Exchange?

Mr. PERKINS. Yes, sir.

Mr. CELLAR. On September 21, 1931?

Mr. PERKINS. Yes, sir.

Now, I am still quoting from Mr. Whitney; he said:

> At one time there were accumulated orders to buy approximately 8,000 shares of General Motors stock at the market. No stock was offered for sale within many points of 30¼, which was the last preceding sale and the highest price that the stock reached at any time during this period. Something had to be done immediately or otherwise the buyers would have bid frantically for the stock and a rapid and entirely unwarranted advance would have taken place.

Surely, such frantic gyrations in a stock with such a small percentage of short interest and which Mr. Whitney has selected as a model of deportment makes undeniable the tremendous influence on market values of the short selling that has occurred.

Mr. Whitney, in his Syracuse address, admits that on October 28th, 1931, 24 per cent of the sales in United States Steel were short sales, 17 per cent of the sales in General Electric were short sales, 10 per cent of the sales in Consolidated Gas were short sales, and 7½ per cent of the sales in North American were short sales. And this was far from the heaviest short burden borne by those stocks, for I find their record in 1931 to be as follows:

United States Steel on October 28 carried a short burden of 251,400 shares, whereas on May 25 it had a short burden of 346,900 shares and its price had dropped to $94¼ from its height of $152⅜ on February 26; the stock rose to $105¾ on July 3 when the short burden dropped to 278,534 shares but fell to $80⅞ on September 11

when the short burden rose to 396,900 shares, and still further decreased to $62¼ on October 5 notwithstanding the short burden fell to 286,800 shares.

General Electric on October 27 carried a short burden of 79,800 shares whereas on May 25 it had a short burden of 242,800 shares and its price had dropped to $38 from its high of $54¼ on February 26; the stock rose to $45 on July 3 when the short interest dropped to 127,480 shares but fell to $35¾ on September 11 when the short burden rose to 144,600 shares, and still further decreased to $24⅝ on October 5 notwithstanding the short burden fell to 67,400 shares.

Consolidated Gas on October 28 carried a short burden of 37,225 shares whereas on May 25 it had a short burden of 42,600 shares and its price had dropped to $86⅝ from its high of $109⅝ on March 19; the stock rose to $100 on July 3 when the short burden dropped to 27,442 shares but fell to $86⅝ on September 11 when the short burden rose to 38,400 shares, and still further decreased to $61 on October 5 notwithstanding the short burden fell to 34,800 shares.

North American on October 28 carried a short burden of 44,900 shares whereas on May 25 it had a short burden of 55,000 shares and its price had dropped to $64⅝ from its high of $90¼ on February 26; the stock rose to $72¾ on July 3 when the short burden dropped to 26,073 shares but fell to $60¼ on September 11 when the short burden rose to 42,500 shares, and still further decreased to $26 on October 5 when the short burden fell to 42,100 shares.

Consider also the experience during 1931 of the following other high-grade stocks:

American Telephone & Telegraph sold at $201¾ on February 26, but was down to $162⅜ on May 25 when it had accumulated a short burden of 96,800 shares, rose to $184⅜ on July 3 when the short interest fell to 49,500 shares, fell to $145¾ on September 18 when the short interest rose to 112,300 shares, and decreased to $121⅛ on October 5 although the short interest had dropped to 84,000 shares on that date.

American Can sold at $129¾ on March 26 but was down to $94⅜ on May 25 when it had accumulated a short burden of 153,300 shares, rose to $114⅜ on July 3 when the short interest fell to 87,685 shares, fell to $88⅝ on September 11 when the short interest rose to 170,400 shares, and decreased to $71⅝ on October 5 although the short interest had fallen to 101,200 shares on that date.

American Tobacco B sold at $132 on April 14 but was down to $109⅜ on May 25 when it had accumulated a short burden on 20,300 shares, rose to $125⅜ on July 3 when the short interest fell to 15,936 shares, fell to $107⅜ on September 11 when the short interest rose to 19,900 shares, and decreased to $78½ on October 2 although the short interest fell to 7,800 shares on that date; it then rose to $94⅜ on October 21 when the short interest fell to 6,700 shares, but here the prospect of increased tobacco taxes made this stock a target for short sellers, on which account the short interest rose to 39,888 shares on November 30 and the price fell to $78½ on that date and went to $64 on December 17.

Drug sold at $78¾ on March 20 but was down to $68⅞ on May 25 when it had accumulated a short burden of 15,500 shares, rose to $73 on July 3 when the short interest fell to 7,743 shares, fell

to $67⅛ on September 18 when the short interest rose to 24,500 shares, and decreased to $42¾ on October 6 though the short interest fell to 3,900 shares on that date.

Allied Chemical sold at $182¾ on February 24 but was down to $106¼ on May 25 when the short interest became 36,200 shares, rose to $133 on July 3 when the short interest fell to 19,417 shares, fell to $101½ on September 11 when the short interest rose to 36,600 shares, and further declined to $68 on October 5 notwithstanding the short interest decreased to 14,500 shares on that date.

The food stocks have a like record. National Biscuit sold at $83¾ on February 24 but fell to $64 on May 25 when a short burden of 29,600 shares had been accumulated; though the short interest fell to 18,527 shares on July 3 the high of the stock for that day was $63½; the price went down to $50⅜ on September 11 when the short burden rose to 26,600, and still further decreased to $38 on October 5 notwithstanding the short burden fell to 10,800 shares.

Borden sold at $76½ on March 20 but fell to $61½ on May 25 when it had accumulated a short burden of 17,300 shares; though the short interest fell to 12,422 shares on July 3, its high for that day was $61; it fell to $53⅝ on September 11 when the short burden rose to 20,900 shares, and still further decreased to $37 on October 5 notwithstanding the short burden fell to 13,300 shares.

Corn Products sold at $86⅝ on February 17 but fell to $58¼ on May 25 when it had accumulated a short burden of 21,800 shares; the price rose to $75 on July 3 when the short burden decreased to 13,230 shares but fell to $58½ on September 11 when the short burden increased to 19,000 shares, and still further decreased to $37⅛ on October 5 notwithstanding the short burden fell to 61,100 shares.

Take some of the more speculative amusement stocks:

Fox Films sold at $38⅜ on February 17 but fell to $12¾ on May 25 when it had accumulated a short burden of 83,300 shares; the price rose to $21¾ on July 3 when the short burden fell to 44,705 shares but fell to $9⅞ on September 18 when the short burden rose to 78,400 shares, and decreased further to $5 on October 5 notwithstanding the short burden fell to 35,200 shares; it was $5¾ on November 30 notwithstanding the short burden had dwindled to 6,804 shares.

Paramount sold at $50¼ on February 24 but had fallen to $23¼ on May 25 when it had accumulated a short burden of 35,300 shares; the price rose to $28⅛ on July 3 when the short burden fell to 7,740 shares but fell to $21½ on October 11 when the short burden rose to $15,600 shares, and still further decreased to $10½ on October 5 notwithstanding the short burden fell to 10,800 shares on that date; on November 30 the short interest was 10,501 shares and the price $11⅞.

Warner Bros. sold at $20⅜ on February 17 but had fallen to $5⅛ on May 25 when it had accumulated a short burden of 139,700 shares; the price rose to $8⅝ on July 3 when the short burden fell to 31,773 shares and to $10 on September 11 when the short burden further fell to 17,700 shares but went down to $5¼ on October 5 and $3⅞ on November 30 notwithstanding the short burden dwindled to 6,900 shares and 8,071 shares on those dates respectively.

I submit these statistics to you——

Mr. CELLER (interposing). Just a minute. Have you got any statistics showing the amount of short selling and the price of stocks down to date?

Mr. PERKINS. No, sir.

Mr. CELLER. During this year, 1932, so far, for example?

Mr. PERKINS. No, sir.

Mr. CELLER. Or the last six months of 1931?

Mr. PERKINS. I have only what the Stock Exchange Bulletin put out, that I mentioned, coupled with the daily price reports.

I submit these statistics to you as a complete substantiation from actual experience that short selling, by its unnecessary increase of selling supply, does cause market breaks, beyond the ability of short covering to repair. Too deadly is the parallel between the movement of stock prices and short interest, too evident the failure of the market to rally between September 11 and October 5, when short covering reached large proportions in the liquidation that had been occasioned.

A striking and conclusive illustration is given by a contrast between what occurred on September 21 and what, according to Mr. Whitney in his Hartford address, caused the committee to suspend short selling on that day. Mr. Whitney says this action was taken because when England abandoned the gold standard—and I quote from Mr. Whitney:

It was certain that no buying power great enough to meet the emergency was to be found in the short interest created by those who had previously sold short and who were committed under their contracts to repurchase. This short interest of 4,241,000 shares on September 18 was at least mobilized and effective.

Yet of the 4,448,235 shares purchased that day, only 280,000 shares constituted short covering according to the official stock-exchange bulletin figures. Even under the extraordinary compulsion of short-sale suspension what the governing committee deemed the mobilized, effective, and only sufficient buying power was merely 6 per cent of the actual buying power that day. Following the second short-interest peak on September 11 liquidation occurred in which the short burden in five days (18th to 23d) fell 1,649,272 shares, while purchases aggregated 14,783,328 shares; but prices fell each day except for a temporary rally on the 23d. On renewed short selling on the 24th this gain was more than lost. And the daily stock price index declined 30 points in the less-than-30-day period from September 11 to October 5, although the net decline in the overnight short interest was 1,867,985 shares. In this supreme test the cushion theory failed—bear profits triumphed.

Those statistics wholly forbid the thought that the 1931 debacle in stock values would have been either as precipitate or as profound but for the tremendous artificial burden which short selling placed upon the market for the express destruction of values to get a profit from the decline. And the figures I have used do not tell the whole depressing and distressing story of short selling. They omit the influence of the large daily "in-and-out" short selling, which Mr. Whitney tells us averaged about 4.75 per cent of the daily sales, and they also omit the "selling against the box," which is simply short selling with the risk minimized by ability to make delivery, should the market rise, from owned shares kept by the seller in his safety deposit box or elsewhere.

Sometimes I think that we are not fully awake to the situation, not simply because of a lack of understanding of the practical nature and working of short selling, but also because we fail to recognize fully two other factors, namely, the extent to which the business of the country is conducted by corporations whose shares are dealt in on the exchanges and the degree to which the public has become "stock-minded" since the World War, due in large measure to their initial investments in Liberty bonds. It is bad enough for the enormous catastrophe to have wrecked values and banished credit, but infinitely worse is the fact that it has annihilated our initiative and confidence. If any of you doubt what I say, let him ask himself why our postal and other savings banks have larger deposits than ever, why our President is organizing a veritable campaign to bring into use again hoarded money estimated to amount to over $1,300,000,000.

The editor of The Financial World very correctly described the situation when he said:

> All that may be said about the technical phases of short selling can not gloss over its baneful influence when it is concentrated on the vulnerable spots in the market's armor during a grave financial crisis when it is everyone's duty to stand by. By pounding at those strategic points of weakness, gaping holes are opened to permit liquidation to surge through until the entire foundation upon which investment faith rests is undermined.
>
> For the public the market has become the clear mirror in which it tries to see the country's financial and industrial condition. More so with us than with any other country, for we have become a stock-minded people owning the bulk of the 1,300,000,000 shares listed on the New York Stock Exchange alone, and through such ownership we are the largest partners in the Nation's business.
>
> What, then, can be a more logical outcome than to see a cloud of apprehension sweeping over the minds of the people as they witness securities cracking day after day, cracking here and cracking there, under the impact of bear raiding, or to use its kid-glove name, short selling? Such operations must pursue these tactics, otherwise they can not turn out profitably. Bears are not philanthropists, they are human, and will turn apathy and weakness to their advantage to gain their goal.
>
> These maneuvers have spread out the vicious circle in widening dimensions; first, by frightening investors into selling their securities, and then breaking down their confidence in our stability. Has not the public the right to ask why nothing was done to curb practices designed to depress values when a critical emergency demanded a ban on such operations until conditions returned to normal?
>
> England, which has had much greater experience with stock markets, did not hesitate to take such action. Germany has found it expedient to apply such a brake. Even Japan took steps when confronted with a similar emergency. But we prate about a free market, and allow predatory speculators to make capital of the country's financial distress, while banks are compelled to close all over the country because their assets have shrunken beneath the point of their solvency and conservative investors are ruined.

Mr. LAGUARDIA. That is from a financial paper, a very conservative paper, is it not?

Mr. PERKINS. It is from the Financial World. Louis Gunther is the editor, and he is the author of that statement. That is a quotation that I have just finished reading.

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Mr. CELLER. Will you explain something about the experience of Germany, in addition to what you have read from that financial paper?

Mr. PERKINS. All right; I will do so later.

What can be done about the matter? For undoubtedly any remedy must come from the outside, not from within. The exchanges have firmly and frankly taken their stand for unlimited short selling. We see how ineffective are the measures they adopt from time to time. And we know the profit inducement to the members of exchanges by reason of the market activity which short selling creates.

Undoubtedly, the States in which the various exchanges are located may pass laws regulating or prohibiting short selling, as well as regulating or prohibiting purchases and sales of securities on margin. The Supreme Court of the United States has rendered decisions sustaining the constitutionality of such laws.

Mr. TUCKER. That is, State laws?

Mr. PERKINS. Yes, sir; those are State laws.

Mr. TUCKER. Will you refer to those decisions?

Mr. PERKINS. Booth *v.* Illinois, 184 U. S. 425; Otis & Gassmann *v.* Parker, 187 U. S. 606.

How far may Congress go? There is the power of Federal taxation. Beyond that it is my opinion Congress can do what the States may, so long as it carefully confines its enactment to the protection of securities issued by the national banks and by the corporations engaged in the commerce committed to the regulation of Congress. For the protection of such instrumentalities and commerce the power of Congress is as supreme within the Federal sphere as is the power of a State within a State sphere. This was long ago expressed by Chief Justice Marshall in the celebrated case of Gibbons *v.* Ogden (9 Wheat. 1, 196–7), where he said:

> This power, like all others vested in Congress, is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the Constitution. These are expressed in plain terms, and do not affect the questions which arise in this case, or which have been discussed at the bar. If, as has always been understood, the sovereignty of Congress, though limited to specific objects, is plenary as to those objects, the power over commerce with foreign nations, and among the several States, is vested in Congress as absolutely as it would be in a single government having in its constitution the same restrictions on the exercise of the power as are found in the Constitution of the United States.

I have already mentioned Board of Trade *v.* Olsen (262 U. S. 1), in which the Supreme Court of the United States held constitutional the grain futures act in its regulations of transactions which wholly occurred on a board of trade within a single State, because of the effect on interstate commerce in grain.

Mr. TUCKER. What is the citation of that decision?

Mr. PERKINS. 262 U. S. 1.

In reaching this conclusion the court cited with approval Stafford *v.* Wallace (258 U. S. 495), where it had sustained an act of Congress enacted to prevent abuses by the commission men and dealers at stockyards, and said of that decision——

Mr. TUCKER (interposing). I do not recall whether that case was prior or subsequent to the decision in the child-labor case?

Mr. PERKINS. Neither do I. You are speaking of the Drexel Furniture Co. case?

Mr. TUCKER. Yes.

Mr. PERKINS. I do not remember, either. I know, however, that the case of Board of Trade *v.* Olsen was subsequent to all of those cases; and in that case the court said, speaking of the case of Stafford *v.* Wallace, and the decision in that case:

> It was held that this could be done even though the sales and purchases by commission men and by dealers were, in and of themselves, intrastate commerce, the parties to sales and purchases and the cattle all being at the time within the city of Chicago.

It also cited with approval its decision in United States *v.* Ferger (250 U. S. 199), where it held constitutional a statute of Congress punishing the forging of bills of lading to be used in interstate commerce, although the fabricated bill of lading had not been so used, because it said:

> Whatever amounts to more or less constant practice, and threatens to obstruct or unduly to burden the freedom of interstate commerce, is within the regulatory power of Congress under the commerce clause, and it is primarily for Congress to consider and decide the fact of the danger and meet it. This court will certainly not substitute its judgment for that of Congress in such a matter unless the relation of the subject to interstate commerce, and its effect upon it, are clearly nonexistent.

It also cited with approval its decision in United States *v.* Patten (226 U. S. 525), where it sustained an indictment under the Federal antitrust law charging a conspiracy to run a corner by making purchases of quantities of cotton for future delivery, although all the transactions had occurred on the New York Exchange.

Any other conclusion would leave at the mercy of any State or Territory the protection, in respects the depression has shown most important, of the banking and commerce which the Constitution has committed to the power of Congress. There is no use to say that the Federal Government can have national banks or that commerce between the States and with foreign nations may be regulated by Congress if the instrumentalities which carry on those businesses may be prostrated through manipulation of their securities. Such was not the conception of Chief Justice Marshall.

Now, I have collaborated somewhat with Mr. LaGuardia in connection with the bill which he introduced; and in my opinion, if you would like to have an expression from me on that, I think that bill takes care of the situation in a way.

Mr. LAGUARDIA. You are referring to H. R. 4?

Mr. PERKINS. Yes; I am referring to H. R. 4. It starts out by Congress enacting and declaring the situation as Congress sees it, just as was done in the grain futures act.

Mr. LAGUARDIA. You are referring to section 3 of H. R. 4?

Mr. PERKINS. I am referring to section 3.

Mr. LAGUARDIA. That is patterned after the grain futures act?

Mr. PERKINS. That is patterned after the grain futures act. Then come along sections which are designed to secure publicity with respect to short selling. It requires that there be a writing which specifies the names of the seller and buyer, in the case of a short sale, with their addresses, the names of the brokers or agents, and the kind of stock purchased and the price. It also requires, when

stock is borrowed for a short sale, that the lender and borrower be named, in a form prescribed by the Federal Trade Commission; and summaries are required to be made of those; and each day, after business is over, that summary must be posted at the place of business of the exchange and printed in a paper circulated where the exchange is located. And the Federal Trade Commission is given authority to prepare those forms and enforce their observance.

And if so be that the Federal Trade Commission finds that any one stock is being sold short inordinately, it is given the power to forbid further short selling in that stock. If it finds that short selling should be totally forbidden, it could do that; but always with the right to the exchange, or those affected, to take the case to the courts, just like any other proceeding in which the Federal Trade Commission acts.

I should like to submit at this point, Mr. Chairman, for the record the two tables to which I have referred, which I have called Schedule A and Schedule B, respectively.

(The tables referred to are as follows:)

SCHEDULE A.—*Showing overnight short interest in 20 stocks (in 1931)*

	May 25	July 3	Sept. 11	Oct. 5	Nov. 30
Number of stocks with short interest	616	597	517	450	556
Total overnight short interest	5,589,700	3,634,261	4,480,400	2,612,414	3,745,642
Allied Chemical	36,200	19,417	36,600	14,500	68,543
American Can	153,300	87,685	170,400	101,200	137,268
American Telegraph and Telephone	96,800	49,500	111,300	84,000	169,012
American & Foreign Power	62,800	117,497	141,600	69,500	56,447
Anaconda Copper	175,600	159,660	113,600	92,000	61,830
Bethlehem Steel	195,900	123,161	154,000	99,900	107,175
Case, J. I.	84,900	71,415	106,200	49,500	73,843
Consolidated Gas	42,600	27,442	38,400	34,800	61,329
Du Pont	116,600	70,469	98,200	76,800	108,271
General Electric	242,800	127,480	144,600	67,400	204,064
General Motors	406,000	245,346	404,000	202,700	401,304
International Telephone & Telegraph	67,200	84,156	121,700	29,500	48,815
N. Y. Central	53,000	38,706	66,200	55,200	73,226
North American	55,000	26,073	42,500	42,100	108,140
Pennsylvania	83,200	29,662	68,700	36,700	31,618
Radio	198,200	110,631	126,900	60,200	48,795
Union Carbide	125,700	75,318	92,100	24,300	36,630
United Corporation	108,000	53,634	40,000	12,900	66,924
United States Steel	346,900	278,534	396,900	286,800	332,387
Westinghouse	172,700	160,452	178,200	99,900	83,145
Total	2,823,400	1,956,238	2,652,100	1,539,900	2,278,766
Per cent	−51	−54	+59	−59	−61

SCHEDULE B.—*Showing overnight short interest in 50 stocks in 1931*

	May 25	July 3	Sept. 11	Oct. 5	Nov. 30
Number of stocks with short interest	616	597	517	450	556
Total overnight short interest	5,589,700	3,634,261	4,480,400	2,612,414	3,745,642
Totals from Schedule A	2,823,400	1,956,238	2,652,100	1,539,900	2,278,766
Adams Express	6,200	14,705	18,900	13,900	17,346
Air Reduction	35,700	22,361	19,900	13,200	12,378
American Tobacco B	20,300	15,936	19,900	11,500	39,888
Atchison R. R.	15,500	21,024	22,000	17,700	23,614
Auburn Auto	13,000	6,790	19,100	13,900	51,301
Borden	17,300	12,422	20,900	13,300	30,988
Canadian Pacific	32,800	38,764	34,500	5,900	9,262
Chesapeake & Ohio	8,100	6,503	10,100	10,100	12,073
Chrysler	71,700	47,172	45,000	16,500	12,246

SCHEDULE B.—*Showing overnight interest in 50 stocks in 1931*—Continued

	May 25	July 3	Sept. 11	Oct. 5	Nov. 30
Coca Cola	7,900	2,965	4,900	18,500	26,860
Continental Can	44,200	10,200	21,000	8,900	14,612
Corn Products	21,800	13,230	19,000	6,100	14,238
Eastman Kodak	37,100	25,255	40,700	35,700	46,211
Electric Power & Light	22,800	24,772	21,900	11,900	36,605
General Foods	39,500	15,675	19,100	7,000	12,891
International Nickel	62,400	27,167	23,500	5,300	20,690
Johns Manville	44,900	37,693	30,700	11,300	22,350
Kruger & Toll	13,400	12,796	39,500	15,000	20,742
National Biscuit	29,600	18,527	26,600	10,800	17,956
Paramount	35,300	7,740	15,600	10,800	10,501
Public Service	16,500	5,910	15,300	19,100	32,586
Reynolds Tobacco	21,500	16,240	11,300	5,400	15,120
Sears Roebuck	37,300	18,256	24,200	11,700	23,624
Sinclair Oil	40,000	47,259	62,800	36,700	41,603
Standard Oil of New Jersey	37,600	27,301	20,200	26,600	24,322
Trans-America	59,700	27,113	27,400	22,600	22,364
Union Pacific	22,300	8,475	16,500	13,000	28,384
Warner Bros	139,700	31,773	17,700	6,900	8,071
Western Union	21,000	14,400	16,700	15,200	20,408
Woolworth	41,600	24,794	17,200	42,000	55,051
Total	3,840,200	2,559,456	3,354,200	1,996,400	3,003,051
Per cent	−69	+70	−75	+76	+80

Mr. TUCKER. Are you through, Mr. Perkins?

Mr. PERKINS. Yes, sir.

Mr. TUCKER. The other members of the committee may want to ask you questions; but before they do, I want to ask one question, to see if I have correctly understood you. But first let me say that we are very much indebted to you—I know the members of the committee feel that way—for your very interesting statement.

Mr. PERKINS. Thank you very much, Mr. Chairman. It was just that I am interested in the subject; that is all.

Mr. TUCKER. You say that Chief Justice Taft's decision in the Grain Futures case invoked the commerce clause of the Constitution as justification for that act?

Mr. PERKINS. Yes, sir.

Mr. TUCKER. And you think that these proceedings and practices which you have detailed constitute a very bad condition of things that ought to be remedied?

Mr. PERKINS. I certainly do.

Mr. TUCKER. And you think that the principles of the Grain Futures case would apply to the conditions in this short selling of securities?

Mr. PERKINS. I do; yes.

Mr. TUCKER. You think, in other words, that it can be justified under the commerce clause of the Constitution?

Mr. PERKINS. Yes, sir.

Mr. TUCKER. Now, I wanted to call your attention—although I suppose you are familiar with it—to Chief Justice Taft's decision in the Child Labor case.

Mr. PERKINS. I remember it very well.

Mr. TUCKER. You remember that in that case—or, rather, the first case, as there were two of them—they invoked first the commerce clause; and then in the other case they invoked the taxing power?

Mr. PERKINS. Yes; I remember both cases.

Mr. TUCKER. And I was glad to note that a few of us who had doubts about the constitutionality of it were sustained by the court.

Mr. PERKINS. Yes.

Mr. TUCKER. In that case, the act prescribed in effect, that any bolt of cotton that was put into interstate commerce, coming from a mill in which a child under 14 years of age had worked for an hour during the year, was denied the right of interstate commerce, and that it could not be shipped in interstate commerce?

Mr. PERKINS. That is true; yes, sir.

Mr. TUCKER. And Chief Justice Taft, with that wonderful common sense that he had, said, in effect, that, of course, this commerce clause of the Constitution was, as Chief Justice Marshall had described it, practically unlimited. But he said, "Here is a thing that all the country knows, that every man, woman, and child in the country knows, that when it was put into this bill ostensibly to regulate commerce, the object of the bill was not to regulate commerce, but the regulation of the police power which belonged to the States." And he, in effect, said what another very distinguished commentator once said, that such a use of that clause was a fraud on the Constitution, because it was using it for a fraudulent purpose; and on that ground he denied the constitutionality under the commerce clause.

And I was just wondering whether there was any application of that decision to this condition. Is that not a police power of the State of New York? As has been said here, the State of New York has passed its laws regulating this, or has attempted to do so, and the Supreme Court has recognized those laws as proper.

In other words, I would like very much to your views on that phase of the subject. I may say in advance that I have great admiration for the opinion of Mr. Chief Justice Taft in that case.

Mr. PERKINS. Well, he distinguishes that in the Olsen case. I know that the Olsen case, which is in 262 U. S.——

Mr. TUCKER. Yes; I remember.

Mr. PERKINS. I know that that came after both the decision in the Child Labor case on the commerce clause——

Mr. TUCKER. Yes; I thank you for that. I remember now how it was.

Mr. PERKINS (continuing). And also after the Drexel Furniture Co. case, which was the Child Labor case on the taxing power. It so happened that I participated, not openly, but behind the scenes in those cases.

Mr. TUCKER. In the Child Labor case?

Mr. PERKINS. Yes, sir. I know the counsel who fought the case.

Mr. TUCKER. Mr. Rogers?

Mr. PERKINS. It so happened that I am familiar with that. Of course, you get a line from those, although those distinctions are hard to make. But you can not let the corporations which carry on the great commerce of this country be prostrated by manipulation of their securities, simply because that manipulation may be carried on in one State, simply because that one State stays its hands and will not act.

For instance, if I may go a little further, when the Sherman antitrust law was passed, the Sugar Co. case, back in 196 U. S.—which is better known as the E. C. Knight case—held as the American Sugar Refining Co., when it bought the stock of a competitor, whereby it got control of 97 per cent of the sugar business in this country, and bought it for that express purpose, had not violated the Sherman antitrust law, because that was an intrastate transaction, whose effect interstate was only incidental.

But when a court came down to the Standard Oil Co. case and the American Tobacco case, it overruled the Knight case, and held that the purchase of stock alone, which was only an intrastate transaction, could violate the Sherman antitrust act, if its effect on interstate commerce was sufficient.

Mr. TUCKER. My familiarity with those questions, Mr. Perkins, leads me to ask you this question: You must have been educated in the law at Washington and Lee University, in Virginia?

Mr. PERKINS. I was; yes, sir. [Laughter.]

Mr. LAGUARDIA. And you had the benefit, then, of studying at the feet of the distinguished scholar and constitutional authority, Mr. Tucker, the father of our distinguished chairman?

Mr. PERKINS. I had the benefit of studying at the feet of the father of our chairman, and also of Mr. John W. Davis.

Mr. CELLER. Mr. Perkins, in the Olsen case, is not the distinguishing feature as given in the opinion of Chief Justice Ttaft to be found in the following language—that is the language distinguishing it from the child labor cases, to which our distinguished chairman has made reference:

> The stockyards are but a throat through which the current flows, and the transactions which occur therein are only incident to this current from the east to the west, and from one State to another. Such transactions can not be separated from the movement to which they contribute and necessarily take on its character. * * * The sales are not in this aspect merely local transactions. They create a local change of title, it is true, but they do not stop the flow; they merely change the private interests in the subject of the current, not interfering with, but on the contrary being indispensable to its continuity.
>
> The origin of the livestock is in the West, its ultimate destination, known to and intended by all engaged in the business, is in the Middle West and East, either as meat products or stock for feeding and fattening. This is the definite and well-understood course of business. The stockyards and the sales are necessary factors in the middle of this current of commerce.

In the case of short selling, the situation is quite different, and would be quite different; and how could you hold that short selling on the New York Stock Exchange would come under the commerce clause of the Constitution, and that therefore Congress had the power to regulate it? Because there you are dealing with a share of stock. The certificate of stock itself is property; and title to it passes to and fro in New York City on the stock exchange. See in this connection Hopkins *v.* United States (171 U. S. 578) and Anderson *v.* United States (171 U. S. 604).

The Chicago Board of Trade *v.* Olsen case was limited in interpreting the grain futures act and therefore has a limited application. The court was also careful to point out that the grain futures act differed from the future trading act. The court refused to sustain the constitutionality of the future trading act in Hill *v.* Wallace (259 U. S. 44). In the latter case the court said:

> It was an effort by Congress, through taxing at a prohibitive rate sales of grain for future delivery, to regulate such sales on boards of trade by exempting them from the tax if they would comply with the congressional regulations. It was held that sales for future delivery where the parties were present in

Chicago, to be settled by offsetting purchases or by delivery, to take place there, were not interstate commerce, and that Congress could not use its taxing power in this indirect way to rgulate business not within Federal control.

Mr. LaGuardia. The certificate is only evidence of property.

Mr. Celler. No; it is property; it is personal property. And here you have a different situation from those cases where something originates in Omaha, for example, comes into Chicago, and finally goes to Cincinnaati.

Mr. Perkins. Yes; but that is what was argued in the American Tobacco and Standard Oil cases. There was, in those cases, a transfer of securities in one State.

Mr. McKeown. Well, your State, New York, claims to be the "neck of the bottle"?

Mr. Celler. No.

Mr. McKeown. All the business goes to it; and if you stop the neck of the bottle you stop that flow.

Mr. LaGuardia. Is it not true, following the reasoning of the gentleman from New York, that a conspiracy entirely entered into in New York on any commodity manufactured in New York, which conspiracy would be in restraint of trade, and which would affect a factory out in California, would be brought within the antitrust law?

Mr. Perkins. That is what the Patten case held.

Mr. LaGuardia. The Patten case held that?

Mr. Perkins. Yes. That was a case where Patten had bought cotton on the New York future exchange. There was a single product, which may not have moved in interstate commerce; but because of its effect on the situation they held it had an effect on interstate commerce sufficient to come within the penalty of the Sherman antitrust law.

Mr. LaGuardia. You have carefully looked into the constitutionality of the provisions in H. R. 4, and reached the conclusion that they are constitutional?

Mr. Perkins. Yes; that is my opinion. And I give it with deference as my opinion—and I am familiar with the cases on the subject.

Mr. LaGuardia. Will you explain to the committee just how the provisions contained in section 4, and thereafter, would cure the evils described which are brought about by short selling?

Mr. Perkins. I think the situation is such that, if you turn publicity onto short selling—that it is something that thrives from lack of publicity. That a man who wants to sell short will go and sell as much as he can; he will sell a lot of stock, and adjust carefully his line, and borrow the stock, and sell again, and try to get a line in the market, all that he can, without anybody being aware that a sale has taken place as an artificial short sale instead of a real sale. And then when he has got his line sufficiently out, he will apply his tactics on the market, through various brokers, and reap the profit on what he has already sold.

And I think if the public can know what is the amount of short interest—the short sales that have taken place, the amount of short interest that is outstanding on these stocks at a particular time, they can be forewarned and can protect themselves. They will know what

is coming; and the Federal Trade Commission will also know, and can act.

Mr. LaGuardia. In other words, it would segregate the purely gambling transactions from the bona fide sales.

Mr. Perkins. It will make the artificial short sale stand out by itself to be known of all men so that the public can know and be protected.

Mr. Tarver. Does not this bill restrict short sales other than by publicity to those transactions?

Mr. Perkins. Except in the later section it says the Federal Trade Commission can restrict them if they think it is necessary.

Mr. McKeown. Why would it not be better, in view of the evils of short selling as you described them—why leave it to the Trade Commission to stop them? The Sabath bill, H. R. 4639 is a bill to prohibit short sales.

Mr. Perkins. Yes.

Mr. McKeown. What is the objection to prohibiting and stopping them? What is the objection to it?

Mr. Perkins. I would not go as far as to absolutely prohibit at this time.

Mr. Tarver. Why not? That is the question that is agitating my mind. I want to know what good there is in it. Why is it legitimate at any time?

Mr. Perkins. I do not think it is.

Mr. Tarver. Why not prohibit it?

Mr. Perkins. Personally, if I had the only say-so about it, I would; but I think, taking it as a practical proposition with other things, with the lack of understanding of it and all the talk that has been made of it, if we begin by trying publicity on it and giving the Federal Trade Commission a chance to stop it if it finds later it should do so, we have adopted a course that is more calculated to have beneficial results than just forbidding it right off. I may be wrong but that is my thought.

Mr. McKeown. I will say that some of us have had some very disastrous results with the Trade Commission where they have gone out with the present set-up and permitted business to engage in practices which were entirely in violation of the antitrust laws, as they did with the set-up and aggreement of this commission. I am just asking you about this bill, which says:

That no broker shall enter into any agreement on his own account, or on behalf of any other person, for the transfer of stock on any stock exchange unless such agreement involves a bona fide transfer of stock, the title to which, at the time the agreement to transfer is made, is in the person on whose behalf or for whose account the stock is to be transferred—

And so forth. Would that stop short selling?

Mr. Perkins. I very much doubt the validity of the bill. It is too broad. It goes beyond what is permitted.

Mr. Celler. That is the Sabbath bill?

Mr. Perkins. It goes beyond what is permitted under commerce. It goes beyond bank shares and other corporations engaged in interstate commerce. That is beyond this agreement.

Mr. Celler. Where that would be in conflict with the New York State law to sell a thing you do not own or possess.

Mr. PERKINS. I would not say whether it is in conflict with the State law.

Mr. MCKEOWN. If they can prohibit absolutely the sale of a share of stock they can prohibit the sale of a pair of shoes.

Mr. CELLER. That is not the question. The Federal statute can contravene a State statute, but only where the Federal power gives Congress jurisdiction. But to regulate a domestic exchange is not a Congressional power. This was clearly pointed out in the case of Hopkins *v.* United States, 171 U. S., at page 598 (this was an action brought by the United States to dissolve the Kansas City Live Stock Exchange) by Judge Peckham, who delivered the opinion for the court:

> We understand we are in these queries, assuming substantially the same facts as those which are contained in the case before us, and if these defendants are engaged in interstate commerce, because of their services in the sale of cattle, which may come from other States, then the same must be said in regard to the members of the other exchanges above referred to. [New York Stock Exchange was included.] We think it would be an entirely novel view of the situation if all the members of these different exchanges throughout the country were to be regarded as engaged in interstate commerce, because they sell things for their principals which come from States different from the one in which the exchange is situated and the sale made.

Mr. MCKEOWN. This says here that it must be bona fide; that is, it is prohibited except a bona fide sale. If I understand trading on margin and short selling, that permits the most shoestring operation I have ever listened to, and I have seen a lot of wildcat propositions in Oklahoma; but short sales on margin is about the wildest thing I have seen. We could not get away with it.

Mr. CHRISTOPHERSON. You have spoken of grain sales. Now, there are future sales on the grain exchanges?

Mr. PERKINS. Yes.

Mr. CHRISTOPHERSON. There are no future sales of corporate stocks on the New York Stock Exchange?

Mr. PERKINS. Yes; there are, in some instances, sales for future delivery.

Mr. CHRISTOPHERSON. Does that involve short selling?

Mr. PERKINS. Sometimes it does and sometimes it does not.

Mr. CHRISTOPHERSON. You may have gone over this, but I am not familiar with it.

Mr. PERKINS. Take a paper man who lives in California. He wants to sell some stock on the New York Stock Exchange. He will get his bank to wire that he wants to sell for delivery on a certain future date. He intends to sell stock that he has and, as soon as he gets a wire that the sale is made, he transfers his stock for delivery.

Mr. CHRISTOPHERSON. But he has that stock.

Mr. PERKINS. He has that stock and intends to sell that stock. I do not think that is short selling.

Mr. CHRISTOPHERSON. That does not involve the brokerage?

Mr. PERKINS. No.

Mr. CHRISTOPHERSON. Supposing I would go to a broker and ask him to sell 100 shares of some stock which I do no own or any corporate stock, and he makes the sale.

Mr. PERKINS. Yes.

Mr. CHRISTOPHERSON. You speak of loaning the shares. He must make delivery to-morrow.

Mr. PERKINS. The stock exchange rules say that all of the shares carried on margin by each member those members may lend for delivery on short sales, and there is a post maintained on the floor of the stock exchange. Your broker will go to that post and announce——

Mr. CHRISTOPHERSON (interposing). And borrow it?

Mr. PERKINS (continuing). And say, I have sold 100 shares of United States Steel, say, and I want to borrow it. The arrangement will be made.

Mr. CHRISTOPHERSON. All I would do is to pay my margin to the broker and he would get the stock?

Mr. PERKINS. What you would have to do in that case is to put up the cash or market value, the share value. Suppose you sold 100 shares of Steel at 50. You would have to put up $5,000, if that is the market price.

Mr. CHRISTOPHERSON. Yes. That is the full market value of the stock.

Mr. PERKINS. Yes; and if Steel goes up you have to finance it; if it goes to 60, you would have to put up a thousand dollars.

Mr. CHRISTOPHERSON. And I have not actually bought that stock yet?

Mr. PERKINS. No.

Mr. CELLER. You have borrowed it on the security of the money.

Mr. PERKINS. On security. He fills the order for the stock you borrowed.

Mr. TUCKER. If Christopherson sent that stock to his broker, does he have to send the $5,000?

Mr. PERKINS. No; the broker has loaned the stock.

Mr. TUCKER. The broker takes it out of his own pocket?

Mr. PERKINS. Suppose I sell shares short and suppose this gentleman is my broker. I give him the order to sell 100 shares short. He takes my order and goes and sells that and then he goes down to this post where he borrows the stock and says, I have sold 100 shares United States Steel short and I want to borrow it. He wants to borrow it. I put that with him.

Mr. CHRISTOPHERSON. The full value of the stock.

Mr. PERKINS. The full market value of the stock in cash. But they don't get the stock yet. I do not buy the stock; I sell it. I borrow it for delivery. He goes to the broker, and suppose Mr. LaGuardia has come with you as a broker on margin. You can lend that stock, but he still owns it.

Mr. CHRISTOPHERSON. That is the vicious part of the whole thing, the lending of the stock.

Mr. PERKINS. That creates the artificial placing of the sale and supplies.

Mr. CHRISTOPHERSON. If I am the seller I have actually put up the full value of it.

Mr. PERKINS. Surely.

Mr. CHRISTOPHERSON. But the condition of lending the stock between them is vicious.

Mr. PERKINS. It creates an artificial sale and supply.

Mr. MCKEOWN. Are they charged with that loaning?

Mr. CELLER. It may be "flat", i. e. no charge, or a charge may be made, depending upon supply and demand.

Mr. PERKINS. It may be flat or they may have to pay interest or a premium. I just heard the other day, according to the newspapers, that United States Steel lent as high as one-half; that is the amount you pay, $50 a day for the privilege of borrowing 100 shares of Steel.

Mr. CHRISTOPHER. Suppose he goes and puts it there and I would put up the $5,000 for that stock and the broker gets that, does he put that up with the man he borrows the stock from?

Mr. PERKINS. Surely.

Mr. CELLER. This money that is put up as security for the loan of the stock in a way helps the broker who has purchased the stock for his customers on margin, does it not?

Mr. PERKINS. I do not consider it so.

Mr. CELLER. Suppose he goes to the bank and borrows money on that stock he purchased for his customer on margin where he would get 70 to 80 per cent of the value of the stock and here he gets from the borrowing broker representing the short seller the full amount on that stock, in that sense he has helped finance his customer's purchase on margin, and those purchases on margin tend to build up the market by increasing prices through additional sales made possible through the additional money borrowed.

Mr. PERKINS. That is an exchange for the amount of stock sold short.

Mr. PERKINS. Isn't that true?

Mr. PERKINS. No; I do not agree with that.

Mr. MCKEOWN. I have to borrow $5,000 on the stock.

Mr. LAGUARDIA. Stripped of the technical phraseology, is it not true that a short sale is a bet; they bet it will go down and others bet it will go up, and the loaning is a technical compliance with certain rules and regulations, to create an artificial condition in a legitimate market.

Mr. PERKINS. An artificial magnification of sale and supply that helps other issues and the buying demand.

Mr. TUCKER. Is there any law in New York against betting?

Mr. PERKINS. Yes; I think so.

Mr. CELLER. On the matter that Mr. LaGuardia suggests, that a short sale is nothing but a bet, Mr. LaGuardia's bill excludes and exempts short sales in odd-lot brokerage.

Mr. PERKINS. For their own business.

Mr. CELLER. So that odd-lot brokerage, since it involves sales, would also be a bet if you believe what Mr. LaGuardia says, that a short sale is a bet. Then short sales involving odd-lot brokerage would also be a bet and a wager.

Mr. PERKINS. Not when you understand the odd-lot business.

Mr. CELLER. It is not true to say that short sales are bets.

Mr. PERKINS. In the sense I defined it and as Mr. Whitney defined it, it is, in my opinion.

Mr. CELLER. You will also agree, in the case that Mr. Christopherson spoke of, the man in California who wires to make a sale when he wants to make the sale immediately, in the New York market, that that necessarily involves a short sale, does it not?

Mr. PERKINS. It may, but I do not think necessarily.

Mr. CELLER. It usually does, does it not?

Mr. PERKINS. No, I think not. You can put it with your banker who sends the wire.

Mr. CELLER. I do not mean that. I mean if you put it with your broker. You made a statement in an article recently about short selling, as follows:

> We might also lay aside all question of short sales to aid delivery of distant owners in order to hedge and that odd-lot houses may function properly.

Mr. PERKINS. Yes.

Mr. CELLER. So, at least, in those two cases where sales are made by distant owners and in cases of odd-lot brokerage, there you sanction short selling?

Mr. PERKINS. I didn't say so there, but I think there are plenty of ways the distant man can sell stock without selling it short. I said I would not discuss that part of it.

Mr. TUCKER. We are very much obliged to you, Mr. Perkins, for your statement.

Mr. CELLER. I have just a few questions that are very important, because certain statements were made that ought to be corrected, and I would like to correct them.

Mr. LAGUARDIA. You will have Mr. Whitney here.

Mr. CELLER. You spoke of the case of Germany. They passed what was known as the Boerse Act in 1896, which prohibited short sales.

Mr. PERKINS. To an extent.

Mr. CELLER. That was repealed in 1908.

Mr. PERKINS. I am not familiar with it.

Mr. CELLER. It was repealed in 1908 because of the bad practices that crept in. Speculation had become uncontrolled. "Fly-by-nights" and irresponsible trades got control of trading. The public had been fleeced. Trading had taken on secret and vicious forms. The Government was compelled to lift the ban on short selling.

Mr. PERKINS. I am not familiar with that. I know that the Brussells Booth forbade short selling not long ago.

Mr. CELLER. Because of the practices that crept up in the market as a result of their prohibition against short sales, the German Government stepped in and said that it was better to have a free wide, and open market with short selling than without it, and the law was repealed in 1908.

Mr. PERKINS. I am not familiar with that.

Mr. CELLER. Are you familiar with the act of 1864 in this country when Congress prohibited the sale of gold futures, short selling in gold?

Mr. PERKINS. No.

Mr. CELLER. You are not familiar with that?

Mr. PERKINS. No.

Mr. CELLER. In 1864 Secretary of the Treasury Chase charged that gold speculators were depressing the price of greenbacks and pushing up artificially the price of gold.

Before he left office he persuaded Congress to pass a bill prohibiting short selling of gold; that is, prohibiting the sale of gold unless it was actually in the possession of the seller and could be delivered by him to the buyer on the day of sale.

After the passage of the bill he said to Horace Greeley, "The price of gold must and shall come down, or I will quit and let somebody else try."

The law was passed June 17, 1864. On that day gold was quoted at 1.98, thefollowing day at 2.08, a day later at 2.30, at the end of the month at 2.50. The cure became worse than the disease. Two days later, without debate or discussion, Congress repealed the act.

You are familiar with some of the operations of the Farm Board, are you not?

Mr. PERKINS. Yes.

Mr. CELLER. The Federal Farm Board and their part in hedging.

Mr. PERKINS. Yes.

Mr. CELLER. Hedging in the commodity market.

Mr. PERKINS. Yes.

Mr. CELLER. Are you aware of the fact that the Farm Board, for example, and I am reading from the Chamber of Commerce of the United States of American bulletin issued September 3, 1930, with reference to the Farm Board's action and their encouragement of short sales and hedging in trading in grain futures, said:

> A striking example of the value of hedging in facilitating credit is furnished by the recent action of the Federal Farm Board in granting loans to co-operative wheat and cotton marketing associations. Those loans, added to those already granted by other credit agencies, amounted to 90 per cent of the value of the wheat and cotton offered as collateral when the commodity had been hedged but to not more than 75 per cent of the value when not hedged. If hedging were not possible through a futures market, banks could not safely grant credit to the extent that they otherwise would. Millers, spinners, merchants, exporters, and the like then would be obliged to furnish more of their own capital or curtail their operations.

In other words, the Federal Farm Board encouraged hedging or in trading in futures in cotton and grain (really involving the same principle as is involved in short sales) by the trading cooperatives, and thereby loaned, as I was saying a while ago, up to 90 per cent of the value of the product, whereas if it was not possible to hedge in the trading in cotton and grain the board would only loan 75 per cent. Are you familiar with that situation?

Mr. PERKINS. No; that is different between hedging and short selling.

Mr. CELLER. That is from the United States Chamber of Commerce bulletin.

Mr. LAGUARDIA. What is their attitude on short selling? They are for it?

Mr. CELLER. Yes; they are against prohibition of short sales. I read further from that bulletin:

> We recommend that the Chamber of Commerce of the United States subscribe to and support the conclusion that trading in futures on the commodity exchanges is in the public interest, through furnishing a continuous, broad, and liquid market in which commodity prices may be protected in advance of consumptive demand and in which also by the process of hedging is furnished protection for those who buy and sell agricultural commodities or their products.

Mr. LAGUARDIA. That stand they take against any regulatory legislation or measure.

Mr. CELLER. I would not say that.

SUPPLEMENTAL STATEMENT SUBMITTED BY MR. WILLIAM R. PERKINS

By way of supplement to the foregoing statement, in order to correlate answers to some of the important questions at the hearing:

The mechanics of a short sale are that the short seller sells through his broker what he desires—say, 100 United States Steel at 50. Delivery must be made by 2.15 p. m. the next day. For this delivery the broker borrows from the "floating supply," namely, shares carried on margin by members under the stock-exchange rules that members may lend such shares. The borrowing is transacted at a post or place maintained on the floor of the exchange for that purpose. These borrowed shares are next day delivered in consummation of the sale when the broker of the purchaser receives them and pays the purchase price thereof. The short seller remains liable to the lending broker for the borrowed shares and all distributions thereon, to secure which he puts up the market value of the shares and maintains that market value, using the money which comes from his purchaser for that purpose, so that he is out only a portion of the market price. The terms of the borrowing are either "normal," "flat," or "at a premium." If the terms are "normal" the borrower puts up the market value of the stock and gets interest upon it, because he remains liable for any distribution by way of dividends or otherwise on the stock borrowed; if the terms are "flat" he puts up the market value, but does not get any interest; if the terms are "at a premium" he not only puts up the market value without getting any interest, but in addition has to pay a premium, which recently in the case of United States Steel amounted to one-half of 1 per cent, that is, $50 a day for each 100 shares of United States Steel.

While a short sale is prevented from being a technical bet under the gambling laws by reason of the actual borrowing and delivery of the shares (Irwin *v.* Williar, 110 U. S. 499; Brooks *v.* People's Bank, 233 N. Y. 87, 96–7), it is a bet in substance and in effect is worse than a bet. It is a bet in substance because it is an artificial transaction wholly and solely to make a profit from a fall in market values. It has no aspects of an investment. It is worse than a bet in effect because a bet affects only the parties to it, whereas short selling acts to reduce the market value of shares and thereby affects all shares of the issuing corporation and all persons interested in those shares as well as the business of the corporation and business in general when short selling goes to the extent of that which occurred in 1931.

I favor H. R. 4 because it is a mean between the extremes of entire prohibition and entire freedom. It proceeds on the basis that publicity will regulate short selling in and of itself to a very large extent; that this publicity can be secured through the powers given the Federal Trade Commission by the act for that purpose; and that in case publicity is not sufficiently effective the Federal Trade Commission under the act can, as respects particular stocks and times, as its judgment dictates, entirely suspend short selling. That is the fundamental of the act, which the other provisions are designed to carry out. On the one hand it permits short selling under the same degree of publicity that a corporation and its officials may increase the stock of the corporation, which should be equally applicable to an increase by short selling. On the other hand it gives power to its governmental agency, to wit, the Federal Trade Commission, to obviate bear raids and the results thereof. It is in line with present-day regulations of banks, railroads, and industrial corporations to prevent abuses.

When we consider the power of Congress to regulate short selling it is a mistake to treat the short sale merely a transfer of pieces of paper called shares of stock and thereby confine the transaction entirely within a single State. This view was taken by the Supreme Court in United States *v.* E. C. Knight Co. (156 U. S. 1), where it held that the Sherman Antitrust Act did not embrace the acquisition by the American Sugar Refining Co. of the share capital of its competitors, though done "to obtain a greater influence and more perfect control over the business of refining and selling sugar in this country" and thereby that company did acquire such control of some 97 per cent of such business, for the reason that in the opinion of the court at that time such acquisition was an intrastate act, the effect of which was only indirect on commerce. Subsequent developments, however, have completely changed that view. In Northern Securities *v.* United States (193 U. S. 197), elimination of competition between two competing railroads by the device of putting their share capital into a holding company was held a violation of the Sherman antitrust law, notwith-

standing it was a transaction entirely in shares of that stock. Then came Swift & Co. *v.* United States (196 U. S. 375), which Chief Justice Taft in the Olsen case (262 U. S. at p. 35) declared to be "a milestone in the interpretation of the commerce clause of the Constitution" because, he said:

"It recognized the great changes and development in the business of this vast country and drew again the dividing line between interstate and intrastate commerce where the Constitution intended it to be. It refused to permit local incidents of great interstate movement, which, taken alone, were intrastate, to characterize the movement as such. The Swift case merely fitted the commerce clause to the real and practical essence of modern business growth. It applies to the case before us just as it did in Stafford *v.* Wallace."

There followed Standard Oil Co. *v.* United States (221 U. S. 1) and United States *v.* American Tobacco Co. (221 U. S. 106), in which there was held to constitute a violation of the Sherman antitrust law the very kind of transaction held in United States *v.* E. C. Knight & Co., supra, not to be violations of that law, and the Knight case can now no longer be regarded an authority. (See United L. W. International Union *v.* Herkert, etc., Co., 265 U. S. 457, 468–9.)

In Ware & Leland *v.* Mobile County (209 U. S. 405) there was upheld a State tax on contracts for the future delivery of cotton, but this case was distinguished in the later case of U. S. *v.* Patten (226 U. S. 525) on the ground that it presented only the question of "the effect upon interstate trade or commerce of the taxing by a State of a broker who was dealing in contracts for the future delivery of cotton," not the effect of those contracts themselves upon commerce.

There have been like decisions holding that transactions on a commodity exchange constitute legal business for certain purposes. (U. S. *v.* N. Y. Coffee & Sugar Exchange, 263 U. S. 611; Moore *v.* N. Y. Cotton Exchange, 270 U. S. 593; and Chicago Board of Trade *v.* Christie etc. Co., 198 U. S. 236.) But this did not prevent the court in the Olsen case (262 U. S. 1) from upholding an act of Congress to regulate such transactions on a commodity exchange because of their effect on interstate commerce.

As a matter of fact, a sale of a share of stock issued by a national bank or a corporation engaged in national commerce is the sale of an interest in that kind of business, and therefore comes perhaps more than a commodity under the regulatory power of Congress for the protection of banking and commerce. It is this principle that has led to the adoption of no par stock, because shares of stock have been recognized as simply a certificate of an undivided interest in the business of the corporation which issued the stock. (Wright *v.* Georgia R. & B. Co., 216 U. S. 420, 425; and Pollitz *v.* Gould, 202 N. Y. 11, 15.)

The legal situation is aptly illustrated by the decisions construing the constitutional provisions on taxation. In Pollock *v.* Farmers' Loan & Trust Co. (157 U. S. 429), which caused the Sixteenth Amendment, it was held that a tax upon the income from real estate was a direct tax upon the real estate, and void unless apportioned as required by the Constitution in the case of a direct tax because "the substance, and not the shadow, determines the validity of the exercise of the power." The clause of the Constitution that prohibits a tax on "articles exported from any State" has been construed as requiring "not simply an omission of a tax on the article exported, but also a freedom from any tax which directly burdens the exportation" and thus to prohibit a tax on the occupation of exporting (Brown *v.* Maryland, 12 Wheat. 419, 445), a tax on bills of lading for articles being exported (Fairbank *v.* U. S., 181 U. S. 283), a tax on charter parties for the carriage of cargoes in foreign trade (U. S. *v.* Hvoslef, 237 U. S. 1), and a tax on policies of marine insurance on articles exported (Thames, etc., Co. *v.* U. S., 237 U. S. 19).

Mr. SABATH. I have Mr. Brown here.

Mr. TUCKER. Mr. Brown, we are very sorry, but the time is so limited.

Mr. BROWN. I can finish in five minutes. I have to go back to Boston.

Mr. SABATH. Mr. Brown has a statement prepared and, in view of the fact that we will not be able to be here Friday, I ask that he be permitted to file a statement.

Mr. TUCKER. Is he a proponent?

Mr. SABATH. He is a proponent.

STATEMENT OF A. S. BROWN, PRESIDENT BROWN'S LETTERS (INC.), ADVANCE BUILDING INFORMATION

Mr. BROWN. In November of 1930, when my office, which publishes daily reports of advance building information, was receiving frequent replies that projects were held up on account of the condition of the stock market, we sent a questionnaire to the Boston architects. As a result of this questionnaire we ascertained that over $100,000,000 worth of contemplated building operations were held up in the offices of the Boston architects who replied. Their letters did not hesitate to state, in nearly every case, that these projects were held up on account of fear and uncertainly inspired by the condition of the stock market. As a result of this questionnaire to the Boston architects we estimated that in New England alone there was over $300,000,000 worth held up for the same reason. The originals of many of these letters from architects I have in my possession.

I also have in my possession letters from life-insurance companies, showing the great increase in their losses on account of suicides caused by financial losses.

You gentlemen know of the great number of bank failures during the past two years.

In October, 1930, I had a long talk with Mr. Richard Whitney, president of the New York Stock Exchange, on the subject of short selling. Mr. Whitney's claim is that the amount of the short interest is too small to influence the market. but claims that it is a cushion when prices are falling and also acts as a curb when prices are too high, but the figures published by the New York Stock Exchange showing the extent of the short interest indicate that the short interest is smaller when prices are high and it increases as prices, through this artificial selling pressure, are driven lower. In other words, the natural law of supply and demand is not being allowed to take its natural course.

As a result of this artificial pressure prices have been forced down to the extent that many individuals, who have had conservative borrowings at the banks, have been obliged to dispose of their holdings through inability to protect their account by putting up further collateral. The banks, through fear of raids, have been obliged to place themselves in as liquid a position as possible. Anyone who has had occasion, during the past two years to obtain commercial loans from banks has realized the difficulty in obtaining loans, which has resulted in the slowing up of business in general.

In explaining what short selling is, Mr. Whitney says: "Let us imagine a man has become convinced that a certain security is selling at too high a price. He feels that it is certain to sell at a lower price in the future and he wishes to take advantage of this situation." Many people believe, however, that the big professional operators attack a stock, having mostly in mind the possibility of success in depressing its price.

Mr. Whitney says: "If it is wrong for a man with credit to borrow stock because he is selling it short, it is just as wrong for a man to borrow money to buy stock or any other kind of property." The man, however, who is buying stock is doing something construc-

tive. He is helping to finance an enterprise whereas the man who is selling securities he does not own is doing something entirely destructive.

On May 25, 1931, he states that "the short interest was 5,589,700 shares, which was only two-fifths of 1 per cent of the shares listed as of June 1." This amount, the writer understands, does not include the short sales, which are frequently made about an hour after the market has opened, when the buying power has been absorbed and covered later in the day when the selling pressure has forced the averages off sometimes as high as from 5 to 10 points. On a day when the total volume of sales is perhaps not over a million and a half shares, one or two hundred thousand shares sold in a few of the leading issues is sufficient to depress the whole list.

It was revealed by the short interest report of last November that the short interest in one stock was over 50 per cent of the total stock of that company. It is only necessary to attack a few of the leaders to depress the entire market.

Mr. Whitney refers to the human judgment and says that "a man should not put the blame for his lack of business judgment upon the market." Many believe, however, that the matter of judgment during the past year or more has had little to do with it, it being a matter more of guess work as to whether or not the professional operators would be successful in driving the prices of securities lower.

He states that were short selling to be prohibited it would mean that no one more than 24 hours mailing distance from New York could freely sell on the exchange the stocks which he owns. Sufficient loaning facilities could be easily arranged for to cover cases such as these.

Mr. Whitney says that "the decline in security prices has not been due to short selling, but has been due to our unsatisfactory business conditions and to the liquidation of securities owned outright or held on margins." That sounds like putting the cart before the horse. The people throughout the country have been so psychologically affected by the continuous depressing of stock prices that they have shut up like clams. It has greatly curtailed private building operation; the purchase of automobiles; traveling; and, in fact, the purchase of everything except the absolute necessities, which, of course, affects the steel industry, railroads, etc. Then when these industries begin to show a falling off in earning power, it is their excuse to depress stocks farther.

In my interview with Mr. Whitney last November, the writer, at the suggestion of a prominent New York broker, asked Mr. Whitney to put a ban on short selling for 60 days. Mr. Whitney stated that it would demoralize the market and make prices fall. What, however, was done in the crisis when England went off the gold standard? They put a ban on short selling and the market immediately went up. The third day they removed the ban and the 2-day gain in prices was immediately lost.

He stated that "the decline in prices has not occurred merely in stocks where short selling is permitting but also in the bond market where short selling is all but impossible because of the difficulty of borrowing for delivery." It would seem as though this fall in the prices of bonds and unlisted securities might easily be explained by

the fact that both bonds and stocks move in sympathy with the general movement and necessitous selling shows no favorites.

He says "there can be no doubt that short selling is a lawful practice and yet Mr. Gerard, an able lawyer, does not hesitate to call it unconstitutional."

Why did other countries like England, Germany, France, and Italy put at least a temporary stop to short selling? Why does Italy, for instance, consider it such a misdemeanor that anyone caught selling short will be sent to their famous island of Lipari?

Mr. Whitney spoke of the decrease in the short interest of 544,000 shares at the close of business on Monday, September 21, and the following day it had fallen 535,000 shares more. He goes on to say that "obviously this rapid exhaustion of the final available and dependable buying power in the market could not continue." In one paragraph he is worried about stocks going up too fast if they continued the ban on short selling and in another paragraph he is worried for fear there wouldn't be enough short interest buying power to check the market, in case of decline.

The writer firmly believes that the board of governors of the New York Stock Exchange is absolutely afraid to put a ban on short selling for any length of time as they well know that the prices of stocks would very quickly rise to their rightful value and they would then be blamed for having prolonged the depression.

He refers to "bear raiding," and says: "I would like to ask just what proof there is." Inferring that there is no bear raiding. He certainly could not expect anyone outside of the exchange to obtain the evidence, but he then goes on to say: "As I have said, the exchange is absolutely opposed to 'bear raiding' and has used and will continue to use all of its power to stop this practice and to discover and punish bear raiders," which, in itself, is an admission that bear raiding is being practiced.

He states that "the stock market reflects business conditions. It is not their cause. It is wrong to say that a ban on short selling could halt our business depression." There are undoubtedly, however, millions of people who do not agree with Mr. Whitney and would like to see an absolute 60-day ban tried out.

If the wings of the New York Stock Exchange had been clipped over a year ago I believe that the business of the country, which was due for some hesitation on account of overproduction, would have been well on its way to recovery: that bank failures would have been not much above normal; that thousands of lives would have been saved from suicide, and our problem of unemployment would have been minimized.

Clip the wings of the New York Stock Exchange and prevent a reoccurrence of the terrible conditions that have existed during the past two years.

I make the suggested remedies:

The present New York State law reads as follows:

Hypothecation of Customers' Securities: A person engaged in the business of purchasing and selling as a broker stocks, bonds, or other evidences of debt of corporations, companies, or associations, who—

1. Having in his possession, for safe keeping or otherwise, stocks, bonds, or other evidences of debt of a corporation, company, or association belonging to a customer, without having any lien thereon or any special property therein, pledges or disposes thereof without such customer's consent; or

2. Having in his possession stocks, bonds, or other evidences of debt of a corporation, company, or association belonging to a customer of which he has a lien for indebtedness due to him by the customer, pledges the same for more than the amount due to him thereon, or otherwise disposes thereof for his own benefit, without the customer's consent, and without having in his possession or subject to his control, stocks, bonds, or other evidences of debt of the kind and amount to which the customer is then entitled, for delivery to him upon his demand therefor and tender of the amount due thereon, and thereby causes the customer to lose, in whole or in part, such stocks, bonds, or other evidences of debt, or the value thereof;

Is guilty of a felony, punishable by a fine of not more than $5,000 or by imprisonment for not more than two years, or by both.

Every member of a firm of brokers who either does, or consents or assents to the doing, of any act which by the provisions of this or the last preceding section is made a felony shall be guilty thereof.

Suggestion No. 1 is that this New York State law might be changed so that, when a broker wished to borrow a customer's security, permission would have to be obtained in every individual case and in any event not over 48 hours previous to the time the security was to be loaned and the loaning permission should contain full description of the security, including the certificate number or numbers. This would then prevent brokers from obtaining the complete control of a customer's securities which he now has when he compels him, when he opens an account, to sign an agreement that offsets the intent of this New York State law. I have with me several copies of these brokers' agreements which are practically identical.

Suggestion No. 2 is to change the present tax law on profits from selling against the box. At the present time a great amount of short selling comes from selling against the box, that is, a man might have 1,000 shares of stock for which he paid $20 a share a few years ago. The stock is now selling for $100 a share, but the market is breaking and he sells short 1,000 shares of this same stock at $100 per share and buys in a week later for $90. He has made approximately $10,000 profit and it is on this profit only that he has to pay a United States Government tax. If the Government would require him to pay a tax on the profit above the original cost, namely on a profit of about $80,000, there would undoubtedly be much less short selling and consequently much less aid to organized bear operators.

Suggestion No. 3. Have a tax of 50 per cent or more on profits made by the sale and purchase of securities; that is, where the sale was made first.

Suggestion No. 4 is that laws might be passed in the various States giving the department from which a broker obtains his license to operate in that State power to grant licenses under certain restricted conditions. Make each broker sign an agreement that gives him (the broker) permission to loan his (the customer's) stock. All reference to the loaning of a customer's stock should be left out of the general agreement, known as a "transfer authorization," which, among other things, gives the broker permission to borrow from the banks on customer's securities. If the customer is willing to allow the broker to loan his stock that permission should be contained in an entirely separate agreement very plainly identified by such words as: Permission to loan agreement. This would give right of contract, yet make it voluntary and more understandable by the customers, the great majority of whom do not realize when

they sign a broker's agreement that they are giving that broker absolute control of his securities, with complete power to loan to himself or others.

STATEMENT OF S. S. HUEBNER, PROFESSOR OF INSURANCE AND COMMERCE, WHARTON SCHOOL OF FINANCE AND COMMERCE, UNIVERSITY OF PENNSYLVANIA, PHILADELPHIA, PA.

Mr. TUCKER. You time is limited. Possibly you can come back again.

Mr. HUEBNER. We have what is known as the Wharton Institute meeting, held only once a year and scheduled for to-morrow and Friday, and I am in charge of the round table in my own subject, and I am afraid I could not be here on those two days.

Mr. MCKEOWN. You might go ahead as far as you can and then insert the rest of your statement.

Mr. CELLAR. Could Mr. Huebner return subsequently to conclude his remarks? We will meet again on Friday.

Mr. HUEBNER. I will be glad to come on any day that I possibly can.

Mr. TUCKER. Proceed now.

Mr. HUEBNER. Short selling is an outstanding practice on all organized markets—both security and commodity—and its origin as an institution coincides substantially with the very beginning of such markets. When business conditions are normal or prosperous, and the price of everything is reasonably high as a consequence, no complaints are heard. But every time that business of all kinds is in the depths of a business convulsion (which seems to have occurred about every 8 to 10 years during the past 200 years) and prices of all things—including not only stocks and bonds but also real estate, mineral products, and wholesale and retail prices of the multitudinous number of nonexchange commodities—are greatly depressed, the reading public is supplied with barrage after barrage against short selling. Comparatively little thought, however, is given to the fact that nonexchange quotations show on the average during each of these business convulsions a price decline fully as great as those established upon our speculative exchanges.

It is only natural to search for an explanation of our constantly recurring business convulsions, and in this connection if short selling is wrong or evil it ought to be prohibited. But if necessary and useful in the maintenance of a free and two-sided market, although never perfect in the sense that none of our good economic institutions are perfect, it should not be prohibited or unnecessarily stifled in its economic functioning. Reasonableness requires that we affix the blame for our recurring business convulsions upon the excessively speculative nature of man—especially during the bull racketeering period of the boom years of the industrial cycle, such as we witnessed last time during 1928–29, and the unwise extension of credit by the billions to back up such speculative excesses for the rise.

The factors which cause the stupendous and forced liquidation in practically all values during a business depression—whether represented on exchanges or not, and usually to a degree fully as great in values not determined on exchanges—are fundamentally economic

and inherently associated with the economic nature of man and would exert substantially the same ultimate influence by way of price declines, irrespective of the presence or absence of short selling. Short selling is not responsible for the unwise buying and the unwise credit commitments and the world forces that cause our periodic economic ups and downs. Speculation, whether on the long or the short side, merely reflects the bearing of those fundamental factors upon values. It passes its collective judgment upon those factors and seeks to appraise them in the form of price quotations. The speculator, be he buyer or short seller, is interested in the correctness of his judgment with respect to the future course of prices. He aims to anticipate the future as regards business conditions. From a practical standpoint, speculators as a group are no doubt anxious to see prices higher rather than lower—at least sufficiently high to please the community—because they know that unusually low prices spell public criticism and endless trouble. When entering upon his commitments, the speculator has no reason to prefer declining over rising prices. There is no need whatever for him to be a proverbial bear, or to be obsessed with a malicious desire to see values decline. Either side of the market will net him the same gain—furnish to him the same motivating force—and his only problem is to consider and interpret facts and to appraise correctly the factors which govern the future movement of prices.

Short selling is a necessary and normal part of an organized market. Before discussing the more general economic functions of short selling, which have been the source of much argument, let us first enumerate briefly its specific services. These I regret to say have received but little attention, despite their outstanding usefulness. Briefly stated they are six in number:

First, to be of greatest value to the community a stock market should be immediate and continuous in its availability for any stock as regards either buying or selling. Stated in another way, the market should be so organized as to enable buyers or sellers to obtain or to dispose of a given stock at any time, even in fairly large amounts, and with comparatively rare exceptions at a price varying but slightly from the last previous quotation. Such a market is of great value to the community in many respects. It gives to securities listed on the exchange the quality of liquidity, i. e., makes them practically synonymous with money. At a moment's notice the security may be converted into cash, if need requires, and creditors and debtors may therefore look to the organized market as a dependable type of credit insurance. Enormous credit may thus be extended on the basis of a reasonably small margin as between current market value and the size of the loan. This creditors are willing to grant because of their knowledge that the collateral may be sold promptly in a dependable market which fluctuates but slightly in the course of an hour or a day. Similarly, holders of money may readily convert the same into securities for investment purposes. There is also assurance of a fairly continuous price quotation service to both creditors and owners, publicly and gratuitously available to all interested parties.

But the factor which gives this dependable continuity is the presence of an ever sufficient group of speculators always ready to buy or sell at any time during business hours. We all know the

lack of dependability of an auction market, with its absence of short selling, and the great variations in price between sales at such a market. To prohibit short selling would tend greatly toward making an auction market of our organized stock market. Dependence upon actual demand or supply in any given stock from the outside public would certainly prove dangerous to the existence of an immediate and continuous market. But fortunately there is a large group (consisting principally of floor dealers who make speculation their life's work) containing a sufficient number at almost any time to meet the need of either demand or supply at reasonably small variations in price. If only owned stock could be sold, a purchasing broker would often find on the exchange no order to sell the amount desired. Much time would be wasted and the price would probably have to be raised considerably before attracting outside attention. Instead, however, the buying broker's bid is usually met promptly by some short seller, present on the exchange, at a small variation in price, and who just previously probably had little thought of making such a sale. Similarly, a sale of stock often could not be made except with the loss of much time and a considerable concession in price, if dependent upon an order to purchase from the outside. However, this sale is likely to be made promptly, and at a small variation in price, to some floor speculator who concludes to cover his short sale in that stock made some time previously. Short selling thus increases greatly the selling and buying opportunities in the market. It makes for an immediate and continuous market. It helps to make a free market, free from auction handicaps.

Second, probably 20 per cent or more of the total purchases and sales on the New York Stock Exchange consists of transactions in odd lots—lots of 1, 2, 10, 50, or some other number of shares less than the regular lots of 100 shares or multiples of 100. In their number these odd-lot transactions probably exceed the total number of regular transactions. They represent the purchase and sales of the millions of our people, who should be given the same opportunity for an immediate market at small variations in price as is accorded to the wealthy. This opportunity is furnished to the millions through the operations of odd-lot dealers, whose business it is either to buy or sell at once, as the case may be, any odd-lot which is offered or desired, and at variations of only an eighth or a quarter from the price prevailing for full 100-share lots.

But imagine the risk and difficulty to the odd-lot dealer in filling such small orders in the absence of short selling. A broker receives an order from his customer to buy 13 shares of a given stock. To avoid delay in finding a seller of this odd amount of stock, as well as the labor and inconvenience altogether out of proportion to the commission charged, the broker goes straight to an odd-lot dealer, who automatically gives the stock at a small fraction above the current price for 100 shares. The odd-lot dealer does not, of course, possess the stock, and can not be expected to do so. All day long he sells odd lots in numerous stocks, and give them automatically as they are asked for and at prevailing prices. The poor are therefore given a market just as continuous and just as good—making allowance for a small fraction of a point—as the well-to-do.

Almost invariably the odd-lot dealer sells the stocks short, and only because of short selling can he render the service. He sells the

odd lot short in anticipation of disposing before long of a total of 100 hundred shares in the given stock. Then he hopes promptly to cover his short sales with the purchase of a 100-share lot in the open market at a price which will yield a profit of about one-eighth. Speed is the very essence of his business. He relies upon the continuous market for the 100 shares, and in all probability manages to purchase the same, before too much time for an adverse price change has elapsed, from some one who sells the same short to him. Thus a short seller, in the open market, helps to protect the odd-lot short seller himself. If that odd-lot dealer were dependent for his 100 shares upon an offering from the outside, where the seller actually owns the stock, he would certainly have to be wary about the risk assumed and would increase greatly the margin between the price at which the odd-lot was given and the prevailing price for 100-share lots.

Mr. CELLER. What would be the increase?

Mr. HUEBNER. I could not exactly say, but it would be very substantial. Personally I would not want to do it for less than two whole points on any active stock.

Mr. CELLER. There are about 17,000,000 holders of stock in this country.

Mr. HUEBNER. Yes.

Mr. CELLER. That increase would affect 17,000,000 holders.

Mr. HUEBNER. And particularly poor people as contrasted with the wealthy.

Mr. TUCKER. Proceed.

Mr. HUEBNER. Similarly, if the broker wishes to sell 13 shares for a customer, the odd-lot dealer will promptly take the same at a small fraction of a point below the price for 100-share lots. Again he anticipates the accumulation of 100 shares before long. Having done so, and not desiring to remain the owner of the shares, he proceeds to the open market to sell the same in the hope that there has been no unfavorable change in price. Here again the continuous market is his insurance. Dependence upon a buying order from the outside would certainly be risky. But in all probability the 100 shares are promptly taken by a floor speculator who desires to cover his short sale in the same stock, made some time previously. It is difficult to see how the present odd-lot system, so beneficial to the mass of our people, could operate without short selling. Risk must be borne by some one, and the odd-lot dealer, in the absence of an immediate market guaranteed by short selling, would not be disposed to take or to give the stock at an eighth or a quarter below or above the prevailing price for 100 shares. The marginal difference would have to be increased greatly against the public, assuming even that the odd-lot dealer would care to continue in his business.

Third, because of short selling owners of securities, unable to deliver at once, may sell the same at a price regarded as advantageous and borrow for purposes of delivery. This advantage applies ever so frequently. Thus the owner of securities may be on a long journey, without desiring to carry his securities with him and without anyone else having access to his safe-deposit box. Securities in foreign countries may be sold, in the regular way and at a price contemplating immediate delivery, pending their transportation to the market where sold. Again, sales may be made against securities

that have not yet been given delivery form by the corporation, but which the seller knows will be delivered later.

Fourth, distributors of stock issues often find themselves faced suddenly with unfavorable, unforeseen market conditions, and the issue then becomes in common parlance an "undigested" one. Unless enabled to hedge this dangerous market position, the undigested issue of which they are long, and which they usually hold on borrowed funds, may involve them in a huge loss. Just as grain and cotton distributors almost invariably insure their accumulations against a price decline through the short selling of an equal amount, so prudence may dictate that the distributor of securities, in the event of a dismal future outlook, may hedge his long account by selling short a sufficiently wide and well-chosen range of other securities, of a similar nature, at current prices on the theory that fundamental changes affect more or less evenly the entire market for that particular type of stock. He operates on the theory that a serious decline of his holdings, occasioned by the adverse circumstances suddenly encountered, will substantially be offset by the profits accruing on the short sales.

Fifth, one of the outstanding features of organized stock and commodity markets is the practice of "arbitraging." Should a stock in one market sell higher than in another, a so-called arbitrager will buy the stock in the low market and immediately sell the same short in the high market with a view to making the difference in price. The practice is beneficial in a number of ways. It tends to level securities to a common price throughout the Nation as well as on the markets of foreign countries. It is also valuable in facilitating foreign exchange transactions. Moreover, arbitragers help to make the market more continuous, their buying and selling adding to the demand and supply which meet the needs of others. But while arbitraging itself aids the continuous market, it is also entirely dependent upon a continuous market if the two transactions are to be made simultaneously in the two different markets without an appreciable variation in the prices prevailing in those markets at the time the arbitrage transaction was undertaken. Moreover, as already pointed out, the continuous market upon which the adbitrager relies, is largely due to the practice of short selling. Again, the arbitrager is himself a short seller in the high market, and can not operate if short selling is prohibited.

Mr. CELLER. Would that prohibition against short selling cause foreign owners of stock, foreign investments, to keep away from the American market and discourage investment in American securities?

Mr. HUEBNER. It would discourage investing but as to keeping them out of the market it would be hard to say.

Mr. CELLER. I mean discourage investing in American securities.

Mr. HUEBNER. To an extent.

Mr. LAGUARDIA. Then it would stop gambling.

Mr. CELLER. You have to have a wide open market for securities. Speculation is necessary. Speculation is not gambling.

Mr. TUCKER. Proceed.

Mr. HUEBNER. Sixth, stockholders in American corporations are very frequently offered the privilege of subscribing to new stock at some price below the current market quotation. This privilege—called a "right" in market terminology—has a computable value

which may be realized by selling the rights in the open market long before the new stock is issued by the corporation. Probably the majority of outstanding stock in America has come into existence via this method, many corporations having increased their original outstanding stock tenfold, or more, in this manner. Moreover, probably the majority of stockholders desire to sell their rights at a fair price, rather than take up the new stock at the subscription price set by the corporation, possibly because they lack the funds and do not desire to borrow, but more probably because they do not wish to overload their investment basket with too much in a single issue.

The matter of selling these rights is therefore an important problem. Yet it is important to know that arbitragers furnish the continuous buying power that accommodates the thousands upon thousands of stockholders in such giant corporations as the Pennsylvania Railroad, the United States Steel Corporation, and the American Telegraph & Telephone Co., when they are all endeavoring in the course of a few weeks or months to dispose of their rights in the market. As the arbitragers buy the rights at a price slightly below their mathematical value, as compared with the price of the old stock, they sell an equivalent amount of the old stock short at the market price and borrow shares temporarily to fulfill delivery. The slight difference in price—usually only an eighth or a quarter—constitutes their profit, and a small payment it is for the stockholder to give in view of his relief from trouble and the immediate receipt of the cash. When the new stock is finally issued by the corporation, possibly some 6 or 12 months later, having been paid for by the arbitrager in accordance with the terms specified by the corporation, the arbitrager will deliver the shares in fulfillment of the loan transaction entered into when the short sale was made. However, if the possessor of rights so wishes, he may sell old stock short for an amount equal to the new shares to be received later from the corporation. In the meantime he has borrowed shares on a short sale, but returns the loan upon the receipt of the shares from the corporation.

Much the same plan is also followed in the marketing of convertible bonds. Where a bond is convertible into stock, the two securities should sell in proper relationship to one another. Should they sell out of line, the arbitrager will buy the low-priced security and sell short the high one. This practice will soon level the two prices to their mathematical equivalent, and the public will have the proper bond market without any of the computations, even assuming that they were able to do the computing. The holder of a convertible bond, should there be a gain derived from its conversion feature, need only sell the same to an arbitrager and receive his cash without going through the process of actually effecting the conversion of the bond into the stock.

Short selling is not a substantial cause of present business conditions. The aforementioned specific services show that short selling constitutes a normal part of a free and efficient stock market. While by no means perfect, just as is the case with any other good economic institution I know of, its services are many and important, and there does not seem to me to be any good reason for prohibiting the practice or restricting it to the point of inefficient operation. In innumerable directions our contractual relations require us to sell

goods and services for future delivery which we do not now own. In other words, we are "short" for the time being of that which we promise to deliver later. Analogous to many other business contracts, the short sale is simply a contract calling for the delivery of stock in the future. To sell a stock without owning it in the present is to my mind no more wrong than to sell commodities or services which we do not possess for immediate delivery. To borrow stock in fulfillment of a sale is, in my opinion, no more wrong than to borrow money in fulfillment of a purchase. And for the owner of stock, or its legal possessor as pledgee, who stands in need of money, to lend the same to a short seller for a loan equal to the current market price of the stock is in my opinion no more wrong than for that same owner of the stock, or its legal pledgee, to pledge it at a bank for a loan of 80 per cent of its market value.

But some may argue: We are not concerned with the legal nature of short selling and its services in normal times; to-day we are in the midst of a withering business depression and short selling is a substantial cause of the misery which has happened.

A little reflection I am sure will result in a more charitable view. The fundamental cause of all business depressions has been excessive speculation during the boom years just before the smash—fanned up to fever heat with the new-era idea and backed up with the generous extension of unwise credit—not only in the stock market, but in real estate, mining, oil production, manufacturing, wholesaling, and retailing. In everything that affords the opportunity for speculation man seems to indulge in that pastime. Securities yielding 2 or 3 per cent on the purchase price are purchased with credit costing 8 to 9 per cent, certainly a wonderful business proposition as was the case in 1929. Securities are bought not for income, but with the idea of unloading onto the next man and that soon. And so in the course of time a vast amount of speculative error—a veritable mass of T. N. T.—is accumulated, backed up with borrowed funds. And in 1928–29, along with all the regular sources of speculative indebtedness, we added the further indebtedness problems of foreign bonds on a gigantic scale and installment buying running into the billions. We feasted at the banquet table of credit, were galvanized into brbavery by the new-era apostles, and then, as has been well said, became thoroughly constipated with debts. The huge mass of explosive was ready for the shock, and only required a mere match of some kind to ignite the fuse. The explosion occurred in October and November of 1929, and then, as always, after the stock market debacle the business depression has to run its course. We then begin to realize that debts remain a constant, whereas the collateral deposited behind the debts is extremely variable in its dollar valuation.

We have a tendency to emphasize the mere match and to forget the vast mass of explosive speculative error. But we finally realize that the real problem is one of debts, debts, debts. There must be substantial liquidation of this indebtedness before we can have a worth-while recovery, and we are now in the painful process of that liquidation. Very much of the liquidation during the past two years has been forced liquidation in the stock market by those who hold stock on margin, or whose stock, although owned outright, had to be sold as the only available liquid assets to protect the nonliquid

business or private estate. The whole Nation, and much of the rest of the world, has been liquidating on the New York Stock Exchange. That market has had a run on it for over two years, just as a bank can experience a run. The problem has really been a forced liquidation of what was owned outright or was held on margin. Nor was the problem confined to individuals who found their loans called or had their borrowing power restricted. Banks, trust companies, insurance companies, and other institutional investors also sold in their desire to be as liquid as possible. Corporations with surpluses in securities were obliged to convert the same into cash to meet pressing needs occasioned by business declines. Everywhere there was forced liquidation to keep business moving in a fashion, and all eyes were turned toward the stock market as the only available continuous market. In the meantime there was an unwillingness to buy by the more fortunate, motivated by a fear that the worst was yet to come.

The seriousness of the problem is indicated by the fact that brokers' loans declined since 1929 from eight and a half billions to about half a billion, or a decline to one-seventeenth of the former amount. During 1931 bonds listed on the New York Stock Exchange, in which there is practically no short selling, declined by twelve billions of dollars, as compared with eighteen billions for all stocks listed on the exchange. And the volume of listed stocks, it should be noted, is much larger than the volume of bonds under consideration. Time upon time, innumerable preferred stocks in which no short selling is practiced tumbled 10 points or more between sales of 100 shares only. Many of the best bonds had virtually no market at times, except at offers four or five points under the previous sale, and many are selling at prices so low as to cause one to wonder why the stocks of the issuing corporations should still be selling so high.

To say that short selling is a substantial cause of present conditions is to emphasize a mere match and to forget the fundamental factors. Hardly one in ten thousand in the United States wants to see lower stock prices. Yet the facts in the situation must be recognized as they are, when the unknowing are possessed with fear, while the foresight of those who know tells them prices will go lower. One may well wonder, in view of all that happened by way of bull racketeering in 1928 and 1929, whether prices should not be as low as they are. Any number of corporations are absolutely in the red, and yet their common stocks are still selling at prices that indicate a real speculative confidence in the future of the Nation. It is hard to believe that the vast moneyed interests of this great Nation and the innumerable people with means could not literally swamp the limited short interest in the market—representing but a few million shares and not more than about 5 per cent of current transactions—any time that they really wanted to if they so desired.

In regard to the stabilizing function of short selling, as already explained, fundamental economic factors exert substantially the same ultimate effect as regards the total range of the price decline during a business depression, irrespective of the presence or absence of short selling. But the real question is: How does that decline take place and what does short selling accomplish as a stabilizer during the

time required by the market to pass from the high to the low price limits? The distance of the downward movement may be the same, but it is one thing to drop abruptly from a precipice through a given distance, and quite another to descend an equal distance by rolling gradually down the hill. Short selling tends to break up the downward price movement into gradual installments over a considerable period of time, rather than have it occur with demoralizing abruptness.

To illustrate, the bear market of the past two years has passed through seven successive new lows. With the exception of the first decline (particularly severe because of the virtual absence of a worthwhile short interest in ever so many stocks) all of the succeeding six downward movements were fairly orderly and free from demoralization despite the blackness of the news. Each successive decline was halted, in large part by the buying of short sellers who had sold previously and who were desirous of taking profits following the decline. In each case the reaction upward was about half of the previous decline, and so stage by stage through seven distinct movements spread over a 2-year period the market gradually moved, without demoralization except in the first instance, to the ultimate level to which it was destined to go in any case because of fundamental economic conditions. In the meantime plenty of opportunity was given to individuals, bankers, and investment institutions to observe the situation and to limit losses before ruin resulted.

Mr. TUCKER. I am advised that our time is about expired. We should be very glad to have you on Friday.

Mr. HUEBNER. If I can possibly be here on Friday, I will be here.

Mr. CELLER. Will you be able to come at a special meeting if not on Friday?

Mr. HUEBNER. My heavy days are on Monday and Tuesday.

Mr. LAGUARDIA. What is it you say you represented?

Mr. HUEBNER. The Wharton School of Finance and Commerce, University of Pennsylvania.

Mr. TUCKER. We are very much obliged to you for coming.

Mr. LAGUARDIA. I take it you are opposed to any legislation?

Mr. HUEBNER. I am not opposed to publicity but I would be opposed to the prohibition of short selling, and I would be opposed to publicity if it is of such an onerous nature as to interfere with the efficient working or the efficient operation of short selling; but I am not opposed to publicity.

Mr. LAGUARDIA. Are you opposed to the provisions contained in H. R. 4?

Mr. HUEBNER. I have certain suggestions I would like to make there, but as regards publicity per se, I am not opposed.

Mr. LAGUARDIA. I will ask unanimous consent that the testimony of Professor Huebner be placed along with that of the opponents of the bill. It is out of its logical order at this time with the proponents of the bill, and it would be confusing. Let the proponents be all together following the custom of this committee and every other committee, and the testimony of the opponents be together.

(Thereupon, at 12.10 o'clock a. m., the committee adjourned to meet again at 10 o'clock a. m., Friday, February 19, 1932.)

HOUSE OF REPRESENTATIVES,
SUBCOMMITTE NO. 3 OF THE COMMITTEE OF THE JUDICIARY,
Friday, February 19, 1932.

The subcommittee met at 10 o'clock a. m., Hon. Henry St. George Tucker (chairman) presiding.

Mr. TUCKER. The committee will be in order. I believe Professor Huebner is here. Professor Huebner, do you desire to be heard further?

STATEMENT OF PROF. S. S. HUEBNER, WHARTON SCHOOL OF FINANCE, UNIVERSITY OF PENNSYLVANIA

Professor HUEBNER. I was asked to be here this morning, Mr. Chairman, because my statement was just about half finished when I was here on Wednesday.

Mr. TUCKER. Yes.

Professor HUEBNER. Now, is it desired that I complete the statement which I filed for the record at that time?

Mr. TUCKER. Well, the meeting of the House has been set for 11 o'clock to-day. Would 10 or 15 minutes be enough for you?

Mr. MICHENER. Well, he says that while he did not finish on Wednesday, he had inserted in the record his entire statement. Do we want him to go and read the rest of it?

Mr. TUCKER. No; if you left it to go in the record, Professor Huebner, it will not be necessary for you to read it, although if you desire to submit anything further, we will be glad to hear you.

Professor HUEBNER. I will leave that entirely to your discretion, Mr. Chairman.

Mr. TUCKER. Well, as we are a little pressed for time to-day, on account of the early meeting of the House, and as you have submitted your statement for the record, we will not ask you to make a statement at this time.

Mr. LAGUARDIA. There are one or two questions that I should like to ask: You are not connected with the stock exchange, I understand, Professor Huebner, in any way?

Professor HUEBNER. No; I am not connected with the stock exchange in any way. I am professor of insurance at the Wharton School of Finance, University of Pennsylvania, and teach the subject of organized security and commodity markets. I was asked by the stock exchange if I would come here——

Mr. LAGUARDIA (interposing). Yes; that is what I wanted to get at.

Professor HUEBNER (continuing). And testify on the economics of short selling.

Mr. LAGUARDIA. That is what I mean—you do consulting work?

Professor HUEBNER. I do consulting work, but am in no way affiliated with the organization of the stock exchange.

Mr. LAGUARDIA. Yes; but in your capacity as a consultant, you were asked to make this statement?

Professor HUEBNER. Yes.

Mr. LAGUARDIA. I want to ask you this question: What is your reaction on the change of policy announced by the New York Stock Exchange yesterday?

Professor HUEBNER. I just had occasion to see the statement in the newspapers this morning; and, assuming that that statement is accurate, I think it is perfectly all right to get the consent of a customer to have his stock loaned. I do not wish to see short selling prohibited, but a regulation of the kind as outlined in this morning's papers I think is satisfactory.

Mr. CELLER. This regulation provides, does it not, Professor Huebner, that, before a broker can loan a customer's stock for the purpose of effecting a short sale, he must obtain the written consent of that customer?

Professor HUEBNER. In the form of a separate consent.

Mr. CELLER. And heretofore there has always been included on an order or instructions to the broker, or on the forms that were used, a general permission to use that stock; is that not true?

Professor HUEBNER. That is correct, sir.

Mr. CELLER. So that the modification announced by the board of governors of the stock exchange is to this effect, that hereafter, before these stocks can be loaned, there must be a specific writing from the customer?

Professor HUEBNER. That is correct, sir.

Mr. CELLER. Now, Professor Huebner, you heard somebody tell at a previous hearing the experience of Germany in prohibiting short selling. Just tell us briefly, will you please, what your reaction in reference to that prohibition was?

Professor HUEBNER. According to my understanding, every time a law has been passed anywhere and has been in existence for a sufficient number of years to test it, the law first proved inoperative, and then was repealed. We have had a good many such laws. Germany, as was stated, once had a prohibition of short selling, according to my understanding, it was subsequently repealed. But we have had legislation in this country repeatedly of the same kind, and in every instance that legislation has been repealed.

Mr. CELLER. Why?

Professor HUEBNER. Well, it did not seem to prove workable, and proved harmful to the existence of the market.

Mr. LAGUARDIA. You mean local laws?

Professor HUEBNER. Local laws and one national law.

Mr. CELLER. The national law was in 1864, at the instance of the Secretary of the Treasury Chase, when he tried to prohibit selling gold futures?

Professor HUEBNER. Yes. At that time gold was selling at a very high premium, as compared with greenbacks. And, according to my understanding, it was felt that that huge difference would be lessened if short selling were prohibited in gold. But, after the lapse of just a few weeks, that legislation was repealed.

May I also say that last year, in the month of May, 1931, I edited a volume on Organized Commodity Markets, which was published by the American Academy of Political and Social Science; and I had one of my colleagues, Prof. Wright Hoffman, prepare an article on legislation, past as well as present, affecting the subject; and I think that article would clear up a good many questions along that line, because the article refers to the legislation. And if I may just take a few minutes, I will point out a few of the bills:

In England, as far back as 1734, according to this article, a law was passed prohibiting short selling. And that law, like some other laws, simply was not enforced; and in 1860 that law was repealed. And it is interesting to note that subsequently, in 1893, England passed a law specifically authorizing short selling.

In the State of New York, in 1812, a law was passed declaring all contracts involving short sales null and void. That law seemed to be ineffective, and was repealed in 1858. And in 1897, New York passed a law specifically authorizing short selling.

In Pennsylvania, in 1841, we had a law prohibiting short selling on all sales that deferred delivery for more than five days. That law was also repealed.

In California, they had a similar statute in 1879, which was repealed in 1908.

Now, that is not a complete list of such laws. It just shows that, in some of the larger States of this country, we have had legislation of this kind; and in so far as I know, in every instance that legislation has been repealed.

Mr. LAGUARDIA. Well, Professor, you would not say that conditions in England are comparable with conditions on the New York Stock Exchange or in this country, would you?

Professor HUEBNER. Yes, sir.

Mr. LAGUARDIA. They are? How often do they have to close all their deals in England?

Professor HUEBNER. Well, they have a fortnightly settlement system, which is two weeks.

Mr. LAGUARDIA. How often do we have them in New York?

Professor HUEBNER. In New York settlements must be made every day.

Mr. LAGUARDIA. Exactly.

Professor HUEBNER. But the short sale, Mr. Congressman, can be deferred just as long in this country as in England.

Mr. LAGUARDIA. Yes. Well, if you are familiar with the conditions in England, you know that conditions there are in fact very different from what they are around the New York Stock Exchange or in this country?

Professor HUEBNER. Yes; I know that.

Mr. LAGUARDIA. You stated, if I remember correctly, that short selling was the matching of one's judgment, or investing on one's judgment. Did you not use that term?

Professor HUEBNER. I think, as I recall, what I said was that the short seller expressed his judgment with reference to what was to happen in the future.

Mr. LAGUARDIA. Exactly.

Professor HUEBNER. And that the function of a short seller was to bring prices on the downward grade to a point where they ought to be, in the light of what was going to happen, just as the function of the bull speculator was to bring prices on the rise to the point where they ought to be, in anticipation of what would happen in the future.

Mr. LAGUARDIA. Now, as an economist, do you desire to take the position that the judgment of a short seller is the proper gage or measure of what the price ought to be?

Professor HUEBNER. I do not mean to say that that judgment is a perfect one; but I believe that, as a group, the short interest represents a very intelligent section of the community. That which we experience to-day, in the form of low prices, probably measures the economic conditions we are actually in. In fact, as I stated in the statement which was filed the other day, many of the bonds of corporations are selling at prices so low that one wonders why the stock of such corporations should still be selling so high.

May I also in reply to that question add this point? A few years ago I had one of my colleagues prepare his doctor's dissertation on the discounting function of the stock market, which is now in book form. He took all the dividend increases, the dividend cuts, and the dividend omissions for all the stocks listed on the New York Stock Exchange for a 10-year period, and traced, with very considerable labor, the fluctuations in the price of the stocks prior to the action taken upon the dividends. And the conclusions of that investigation show a remarkable accuracy on the average in the discounting function of the speculative market, either up or down. For instance, as regards accuracy within 5 per cent, I find that somewhere around 85 or 90 per cent of all the dividend changes were foretold in advance.

Mr. MICHENER. May I ask you just one question, Professor Huebner?

Professor HUEBNER. Certainly.

Mr. MICHENER. You have given considerable study to this matter; and may I ask if it is your judgment as an economist that there is sufficient information available to warrant the regulation by Congress of short selling?

Professor HUEBNER. That is a difficult question for me to answer, because I do not know just how much information the stock exchange as an organization has. But as I said, the last time I was here, I am not opposed to publicity. I believe in publicity. I think that we should have available somewhere the facts, so that if we believe there is something unnatural at any particular moment, we may arrive at a judgment based upon facts.

Mr. MICHENER. Yes. Now, there is a distinction between legislation providing for publicity and legislation providing for regulation of action. From your study, and from the information you have, do you think you would be warranted in recommending regulatory legislation by Congress?

Professor HUEBNER. I personally would not be in favor of legislation regulating the stock exchange. I said throughout the hearings of 1914 on this question, and it is now my feeling, that from the standpoint of the highest discipline, the New York Stock Exchange had better be given the full control over its membership and the "firing" of any member when some of its rules are violated.

Mr. LAGUARDIA. Well, if you would give the New York Stock Exchange full control over its membership, would you not have any one with power to have control over the New York Stock Exchange?

Professor HUEBNER. The trouble is that, if we give legislative control over the stock exchange, a member who is suspended would probably seek redress, and the exchange be compelled to keep him on until he is actually proven guilty; whereas the procedure on the

exchange is to suspend a member until he proves himself innocent; and in the meantime everybody would have to continue doing business with that member.

Mr. LaGuardia. Well, there are a lot of "sharks" who are members just the same.

Mr. Celler. Professor Huebner will you explain exactly what hedging is in the commodity markets?

Mr. LaGuardia. We have no bill here covering that.

Mr. Celler. No; but that has been used as an illustration.

Mr. LaGuardia. No; we have a commodity bill before the Committee on Agriculture.

Mr. Celler. Professor Huebner, is hedging simply short selling?

Professor Huebner. We have to have a short sale to conduct a hedge; yes, sir.

Mr. Celler. Will you please explain briefly what hedging is?

Professor Huebner. Hedging is insurance. Its purpose is to insure a trade profit. Its purpose is to insure the dealers in grains against the speculative hazard connected with price variations in the huge amount of commodities which they are obliged to carry over from time to time.

Mr. Celler. Are you familiar with the Garfield cotton report in 1906, concerning hedging in the commodity market, when it was stated short selling in cotton was helpful to the farmer and spinner?

Mr. LaGuardia. That has no bearing on this matter. We have another bill on that.

Mr. Celler. The principles are exactly the same.

Mr. LaGuardia. No. There is another bill, and that has no more connection with this than a bill regulating betting on horse racing would.

Mr. Celler. Professor Huebner, is there hedging on the stock market?

Professor Huebner. Yes, sir.

Mr. Celler. Is that for the purpose of insurance?

Professor Huebner. Yes, sir.

Mr. Celler. And if you had a prohibition against short selling in general on the stock market, would you not also have a prohibition against hedging in the way of insurance?

Professor Huebner. Yes. In the security market they do to some extent although not to the great extent that they do in the commodity market. Distributors of securities frequently hedge an unadjusted security with which they are caught, by making short sales over a widely distributed list of similar securities on the stock exchange.

Mr. Celler. From your studies, would you say that the previous statements which have been made here are true, that the tremendous decline in stocks and commodities was, in the main, caused by short selling?

Professor Huebner. In my statement which I filed with the committee—and all of which I did not have the time to read—I took the position that the decline in securities and the bad times which we had, are not to be attributed to short selling. Short selling is not a substantial cause of a business convulsion.

Mr. Celler. Is there any short selling in real estate?

Professor Huebner. Probably to a limited extent; not much.

Mr. Celler. And has there been any great decline in real estate?

Professor Huebner. Just as much as in securities.

Mr. Celler. Has there been any great decline in bonds?

Professor Huebner. To some extent there has, but not much.

Mr. Celler. Has there been any very great decline recently in bonds?

Professor Huebner. Yes. Last year the price of bonds listed on the New York Stock Exchange showed a decline amounting to about $12,000,000,000, as compared with a decline of about $18,000,000,000 in stocks; but the volume of stocks is much larger than the volume of bonds; so that one may say that the decline in bonds, even, was about as great as the decline in stocks. That is, in the year 1931.

Mr. Celler. A gentleman who appeared at the last hearing said something about the occasion when Japan did something about prohibiting short sales. Are you familiar with the situation there?

Professor Huebner. I happened to be in Japan in 1927. And Japan is a great country for exchanges. They have many more exchanges than we have. All sorts of commodities in Japan are subjected to organized exchanges, and even potato dextrose and cotton yarns and dried fish, and fertilizer, and so on, are dealt with on exchanges. I happen not to know of any movement just at the present time; but I am rather reluctant to think that Japan would prohibit short selling, because the Japanese are quite clever in knowing what is best for their interests.

Mr. LaGuardia. Well, the orientals are gamblers, too, are they not?

Professor Huebner. They are speculators—and there is quite a difference between speculators and gamblers.

Mr. LaGuardia. Yes; the difference is between a short seller and a "tin horn" gambler.

Mr. Celler. You do not mean that.

Mr. LaGuardia. I mean that exactly.

Mr. Celler. Professor Huebner, is speculation essential in all markets?

Professor Huebner. Yes, sir.

Mr. Celler. For the purpose of having a wide open market?

Professor Huebner. Yes; our life is, in a way, a sort of speculation.

Mr. Celler. Of course, in principle short selling is proper. It is the abuse of the right in times of distress and trouble that is dangerous.

Mr. Condon. Professor Huebner, may I ask you a question?

Professor Huebner. Certainly.

Mr. Condon. You said something about publicity. Do you recommend legislation that would produce publicity of these short-selling operations?

Professor Huebner. I think there would be no harm in asking the stock exchange to keep a record on short sales.

Mr. Condon. Suppose it was required by law?

Professor Huebner. For instance, the bill that you have before you eliminates the odd-lot dealer. I think that section of the bill is good, inasmuch as the number of short sales made by odd-lot dealers is simply enormous; and to require the maintenance of a detailed record would prove onerous, I am sure. But in my statement filed

with this committee I called attention to the fact that a continuous market is brought about by floor dealers, who also make an enormous number of short sales, usually only for a day, or a few days' duration.

I also pointed out that arbitrators must make a short sale every time they conduct their service. And I feel that, in addition to the odd-lot dealer, certain other groups might also be excluded, in order to make the compilation and the filing of material or facts not too onerous.

Mr. CONDON. One more question: Is it your belief that legislation that would require publicity would cure any abuses of short selling that might now exist?

Professor HUEBNER. I think that publicity would accomplish the purpose that, if there should be some scoundrel who is doing something that is really outside the legitimate limits of short selling, we would get facts and probably could take some action against that individual.

Mr. CONDON. Would it promptly disclose the organized short selling that has been referred to in the testimony of others before this committee as being harmful—where great groups get together to hammer down the stocks?

Professor HUEBNER. That is hard to answer. I think it would require an investigation to pin the responsibility upon any particular group. Furthermore, may I add that I do not believe it desirable to make public the names from day to day.

Mr. CONDON. Why not?

Professor HUEBNER. In the same sense that a buyer of stock would not want his name made public—that is, making every name public. It is only, of course, in the case of wrongdoing that names should be made public.

I may say that I do not understand just what is meant by the word "summary" in the bill. If "summary" means merely a statistical summary, rather than revealing all the names, it would not be so harmful. I imagine that is what is meant.

Mr. CELLER. That reasoning would apply to the farmer also?

Professor HUEBNER. Yes; in the produce market I guess most people hedge; and I suppose it would apply to the Farm Board, because the Farm Board has hedged.

Mr. CELLER. The Farm Board has hedged?

Professor HUEBNER. Yes, sir.

Mr. CELLER. In other words, the Farm Board has indulged in short selling?

Professor HUEBNER. I do not think the Farm Board has created any machinery other than that which was already in existence when the Farm Board act was passed.

Mr. LAGUARDIA. You do not think that we should take the Farm Board as a model, do you?

Professor HUEBNER. Well, it is what you have in the grain system to-day. I do not know how ideal it is.

Mr. CONDON. You read a list of statutes in the different States that had been repealed—statutes which prohibited short selling. Do you happen to know the reasons given for the repeal of those statutes?

Professor HUEBNER. No; I do not happen to know just what the reasons were.

Mr. CELLER. Do you know the reason why the "gold futures" act was repealed?

Professor HUEBNER. Yes. And I dare say the reason was the same in all instances; but those acts were passed so long ago, and repealed so long ago, that I have had no opportunity of seeing just why they were repealed?

Mr. LAGUARDIA. Short selling had not achieved the magnitude then that it has achieved to-day, had it?

Professor HUEBNER. In the percentage that their magnitude had to the total number of securities than in existence, I imagine that it was just as large as it is to-day.

Mr. SUMNERS. Mr. Chairman, I would like to ask one or two questions?

Mr. TUCKER. Certainly.

Mr. SUMNERS. You stated, Professor Huebner, as I understood you, that short selling is a reflection of the judgment of the seller, or something to that effect?

Professor HUEBNER. Yes, sir.

Mr. SUMNERS. Now, is there or not associated with this short-selling movement that indicates the judgment of the seller, what is known as manipulation of the stock, and if they have large totals of sales on the short side of the market, do they not sometimes go into the market and try to break the market, in order to win their bets, so to speak, on the short side? Is that a bad practice or not?

Professor HUEBNER. Why, manipulation is not a good thing. And we have manipulation on the decline, just as we have manipulation on the rise. I think in 1928 and 1929, during our banner good days, we had a volume of manipulation away in excess of the manipulation which we have had during the past two years.

Mr. SUMNERS. Let me ask you another question: Do you think it would be a wise public policy to prohibit that character of manipulation in short selling, even though short selling has its useful functions?

Professor HUEBNER. I am inclined to think that the stock exchange would express the utmost thanks if some way could be found, under the right of contract, to prevent the bad forms of manipulation; yes.

Mr. SUMNERS. Is not the difficulty about the stock exchange regulating itself that the more transactions there are on that stock exchange the more profit comes to the men who hold seats on the stock exchange?

Professor HUEBNER. That is true of any business—the larger the volume of business the more money is made.

Mr. SUMNERS. Let us see about that: We are dealing now with the hope that they will regulate themselves. Is it sufficient or wise as a matter of public policy to entrust regulation which would mean a reduction, perhaps, of profits to the agency whose profits might be reduced, but which would be increased by increased transactions? In other words, if you have a situation that is wide open, where the volume of transactions on the exchange is limited only by the ability and disposition of people to gamble, would it be quite a reasonable

thing to expect the people who own the seats on that exchange to limit the amount of gambling? I will put it that way.

Professor HUEBNER. Well, some times the profits of commission houses have been enlarged; but certainly, within this past year, the volume of transactions has been extraordinarily small. I imagine there are a good many houses that were not able to pay their electric light bills last year.

Mr. SUMNERS. That is all I have to ask. Thank you very much, Professor Huebner, for answering my questions.

Mr. TUCKER. We are very much obliged to you, Professor Huebner, for your statement.

Professor HUEBNER. Thank you.

STATEMENT OF HON. CLYDE KELLY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. TUCKER. We will now hear from Representative Kelly.

Mr. KELLY. Mr. Chairman, I appreciate the opportunity of speaking for a moment before I go to another committee, where we are having a hearing this morning.

I did not want this hearing to close without urging with all the emphasis I have that you take action to deal with this short selling, which, in my estimation, is a vicious practice, injurious to everyone except to those who are endeavoring to profit through gambling. After all, that is the principle involved—gambling which takes security out of securities.

In my district, a great industrial district, I have thousands of constituents who have invested in the stocks of their employing companies, the United States Steel Corporation and others, at the request of the companies, the money being paid from their wages. Those employees, some of them, took United States Steel stock on such payments at as high as $150 a share. The stock is now worth one-third of that amount.

I consider that much of that situation is due to the practice of short selling, which is selling stock that is not owned, in the hope that it can be bought at a later date at a lower price and thus a profit be made. It is gambling, and there is no benefit in a gambling system like that to the great mass of Americans.

George Washington, whose bicentenary we are about to celebrate, said of gambling, that "it is the child of avarice, the brother of iniquity, and the father of mischief."

In my opinion, short selling has all of those qualifications. It is the child of avarice, because no short seller acts from any other motive than greed. He is not desirous of advancing the welfare of his country, but because of a desire to profit out of the exigencies of his country, he sells stock that he does not own, hoping to buy it back at a lower price later on.

It is the brother of iniquity; because there is no greater iniquity than the beating down of honest values—and the prices of stocks to-day, as you know, do not represent values at all. The values are in the properties, but the stock does not show it.

Such a system is the father of mischief for it injures us all. Part of this great army of unemployed, 8,000,000 men walking the streets, looking for a chance to work—are suffering because of the destruction of confidence in the securities of the companies doing business in the United States.

The stock exchange has a proper purpose. It ought to be operated for the transfer of securities. It ought to make it possible for an individual to buy stock and thus have a part ownership of these great companies. Those securities ought to be sold and bought at some recognized market place.

But when you inject into that this gambling feature you destroy the real purpose of a stock exchange.

My bill, which is before your committee, endeavors to reach the evil by refusing the use of the United States mails, the telephone, the telegraph, and other means of interstate communication for these various quotations and orders, where there is no bona fide delivery of stock.

I have no pride of authorship in the bill introduced. I presented it in the last Congress, hoping that we would get some action. Other bills are also before you. I hope that you will bring out some bill, and bring it on the floor of the House, whereby we will have a chance to vote on it and consider it, and adopt some plan of dealing with a practice which is injuring the great mass of Americans. There is an opportunity for this Congress to put an end to the practice that means such injury, and I consider that this Congress has a grave duty in such a situation as that.

I thank you, Mr. Chairman and gentlemen, for the opportunity to address you.

Mr. LAGUARDIA. May I ask you a few questions Mr. Kelly?

Mr. CELLAR. I would like also to ask you a few questions, Mr. Kelly.

Mr. KELLY. May I have an opportunity, Mr. Chairman, to add a statement that I have not here with me to-day, but which I would like to go in the record?

Mr. TUCKER. Yes.

(The statement referred to is as follows:)

Mr. Chairman, my friend, Samuel E. Bramer, of Pittsburgh, a prominent business man and public-spirited citizen, prepared at my request, an analysis of the address of President Richard Whitney, of the New York Stock Exchange, in which he defended short selling in stocks and in securities. It is as follows:

"Mr. Whitney states that the short interests are essential to the welfare of the security market. He further cites the Supreme Court ruling of Mr. Justice Holmes, and also esfablishes certain justifications.

"First, I disagree with Mr. Whitney's statement that the short interests are essential to having a ready market.

"Second. That short interests are essential to prohibit skyrocketing of securities.

"My answer to the first problem is that the security market should only be in existence to take care of the legitimate purchaser for investing purposes. I agree that if Wall Street is permitted to invite gambling and speculation, then Mr. Whitney is right.

"I disagree with Mr. Whitney in the second problem, because if securities are skyrocketed, and you and I own certain stocks, no one would prevent us from selling and enjoying the profit, and then waiting for a more stable market to repurchase the stock we sold or such additional stock due to our profits on the original sale.

"This in a measure answers Mr. Whitney's fear of skyrocketing, and also lack of a ready market.

"Mr. Whitney entirely avoided the real issue, with which he is fully familiar and the illegitimate operations and rottenness of which he thoroughly understands. Mr. Whitney knows that there is a given number of large

reputable brokerage houses in New York as well as in every large State in the country, who specializes in pool operations. Their existence is known and respected by Mr. Whitney and his associates. This pool operation secures an understanding group of men.

For illustration, we read of the large pool in 1929 that was operated by a clever New York broker who has made hundreds of millions of dollars in its operation, and who had on his staff notable financial characters. This broker would sell stock long to the buying public, and gradually manipulate the advance prices, creating a fictitious buying power, and when he would bring up the issue to a certain level in accordance with his judgment, he would immediately sell short. In other words, he creates one set of innocent purchasers by virtue of Wall Street membership and his standing. The public believes in him and he sells it securities. When he has sold sufficiently, he deliberately starts the second campaign of selling short. The net result is that he literally robbed the public by this very operation.

That, you will note, Mr. Whitney has evaded completely, and it is one of the sins of our modern civilization. Further, I believe we have reached a stage in life and that we have paid such a serious price in the ruining of millions of purchasers of securities by legalized gambling.

Wall Street must be the clearing house for purchasing and selling security, and it must be limited to that and that alone. It must be cleaned of all gambling and its fictitious operation. It must not be permitted to induce widows and others with little capital to invest their money on one hand, and at the same moment be robbed of it.

The necessity of short purchases is fictitious, and there is only one who gains—the operator and gambler—and gaining from whom? From the rank and file of innocent investors. No man dare to state that this is essential. There will always be an orderly market in orderly periods. In time of depression there will be an orderly liquidation, and those who have funds will avail themselves of profit. There won't be such a period as we have gone through, in which a group of men will be buying 4,000,000 to 5,000,000 shares of stock, causing a radical decline in that stock because of short selling, hammering the value to such a figure that has killed the protective margin that the general public had in its banks. This was a real cause of the forced liquidation of the final panic of the market.

Mr. Whitney is certainly wearing clouded lenses, and he does not want to face the fact. On one hand he admits that when England went off the gold standard to protect the security market it was forced to ban shorts. That, in itself, is a serious admission and confirmation against short selling. On the other hand, he says that 5,000,000 shares is a small block of stock. You and I and every thinking person know that any group with a purchasing power or selling power of 5,000,000 shares can create a panic whenever it pleases. It can hammer that stock down to such prices, and the short interests know that and continue to sell until it has released blocks of stock that are held on margin, which is the only way the short interests can profit.

I say, and I believe that this can be confirmed, that the short interests were responsible for this serious panic. They brought on this forced liquidation. An orderly liquidation would never have caused this crisis by banks foreclosing on the general public due to the continuous decline.

I do hope that Congress will not be influenced by Mr. Whitney's address. It is well understood that if the short interests were eliminated or minimized, if pool operations were a criminal act, which they are, the brokerage business would be less profitable, the exchange seat would be less valuable, and Wall Street would not be transacting 2,000,000 to 3,000,000 shares per day, but an orderly volume to meet the world's requirement in purchasing and legitimate selling.

Mr. CELLER. May I ask you one or two questions, Mr. Kelly?

Mr. KELLY. Yes.

Mr. CELLER. I was interested in hearing you state that the man who sells short is selling an interest in a stock that he does not own.

Mr. KELLY. Yes. He sells it, hoping to buy it back later at a lower price.

Mr. CELLER. What of the man who buys stock on margin, not having any investment interest in it, but merely for the purpose

of making a quick turnover of profit? Is he not doing the same thing in principle?

Mr. KELLY. I am not interested in protecting the margin buyer. I am interested in the actual possessors of these stocks—the employees of the United States Steel Corporation, who own the stock of the corporation, having bought it at the company's suggestion, and who have seen values destroyed by manipulation on the New York Stock Exchange.

Mr. CELLER. In other words, you think that the purchase of stock on margin is also reprehensible?

Mr. KELLY. I think there should be a bona fide delivery of the stock intended in every case; and if a so-called margin deal has no connection with the actual delivery of the stock, I think it is a reprehensible practice.

Mr. CELLER. Would you deny the use of the mails or the telegraph and telephone in interstate commerce to transactions on margin, where there is no actual delivery of the stock?

Mr. KELLY. My bill covers all cases where there is no intention to deliver the stock.

Mr. CELLER. That is, either way—whether it is a purchase or a sale?

Mr. KELLY. Where there is no idea of delivery. I would like to see honest demand regulate the value of these securities, rather than gambling.

Mr. CELLER. If you do not have purchases on the market, you do not have short selling; that is, you would not have the element of speculation on the market?

Mr. KELLY. Well, I have no objection to installment selling of stock—if you call that on margin, all right; but where there is merely a bet that a stock will rise, or that a stock will fall, I consider that a reprehensible practice, injurious to everybody.

Mr. CELLER. Well, I say, if you take out the margin purchases and short sales, that would remove every element of speculation in the market; that is almost elementary in principle.

Mr. SABATH. It will resolve itself into legitimate dealings.

Mr. KELLY. Any speculation will have its effect on the market; but this is the point I want to emphasize, that the practice of selling a stock you do not own, on the gamble that it will fall in price, is injurious.

Mr. CELLER. You believe that reasonable speculation on the market is good, do you?

Mr. KELLY. Speculation, where there is an actual desire to buy any stock; but this is an entirely different thing from reasonable speculation. It is gambling on an artificial price of a stock.

Did you want to ask me a question, Mr. LaGuardia?

Mr. LAGUARDIA. Yes. Do you feel that the price of stock ought to be governed by the book value of the property of that corporation, by its management, by its good will, and by its profits—and not by wild gambling?

Mr. KELLY. Absolutely.

Mr. CELLER. What about bonds? They are not selling now as based on the true value, or the book value. There are a great many factors which control the price of bonds, and there is practically no short selling.

Mr. KELLY. Well, the price of bonds in some degree reflects the prices in stocks, without a doubt.

And further, in reply to Mr. LaGuardia, I will say that I have a personal friend, an employee of a certain company, who bought the stock of that company at $160, and saw it go down to 30. He told me that at the very time it was selling at such a fictitious low price, there was more in the surplus of the company than sufficient to take the whole stock of the company at that price. That is an injury to everybody; and the responsibility is upon this committee, and upon Congress, to deal with that evil.

Mr. CELLER. And when that man bought that stock at the peak price, that was a price that had been run up by hysteria in purchasing, was it not? It was the bull market, was it not?

Mr. KELLY. No; the actual value was behind that highest price. As I say, the surplus of the company alone would take care of the stock that had been hammered down by artificial speculation.

Mr. TUCKER. We are very much obliged to you for your statement, Mr. Kelly.

Mr. KELLY. Thank you, Mr. Chairman.

Mr. TUCKER. We have Professor Stagg, of Princeton University, and Mr. Cummings, of Portland, Me., who, I believe, also desires to be heard.

Now, our time is limited. Is Professor Stagg here?

Professor STAGG. Yes, Mr. Chairman.

Mr. TUCKER. Professor Stagg, we are in this position to-day: The House is to meet at 11 o'clock; our time is therefore very limited. From the bundle of papers you have brought in, you seem to be "loaded for bear." [Laughter.]

Professor STAGG. Yes, sir.

Mr. TUCKER. Perhaps on the bear side of the market? [Laughter.]

Professor STAGG. Yes, sir.

Mr. TUCKER. How much time do you want?

Professor STAGG. I am afraid I shall require over an hour to present my case.

Mr. TUCKER. Mr. Cummings, how much time do you desire?

Mr. CUMMINGS. About 15 minutes, Mr. Chairman.

Mr. TUCKER. You are for or against the bill?

Mr. CUMMINGS. I am for the principle of stopping the gambling in stocks.

Mr. MICHENER. Are you for or against it, Professor Stagg?

Professor STAGG. I am against the bill, sir.

Mr. MCKEOWN. How much time do you want, Professor Stagg?

Professor STAGG. I am afraid I shall have to have over an hour.

Mr. MCKEOWN. I suggest, then, Mr. Chairman, as we have only a few minutes, that we hear from the gentleman who wants only 15 minutes, and allow Professor Stagg to be heard later.

Professor STAGG. Yes; I prefer to have the time uninterrupted to present my case.

Mr. MCKEOWN. Then we will hear from you later.

Mr. TUCKER. Professor Stagg, we will notify you when we can hear you. Can you come on any day that we indicate?

Professor STAGG. Yes; any time that suits the convenience of the committee.

Mr. TUCKER. Then the clerk of the committee will notify you; and we will be very glad to hear from you.

STATEMENT OF FRANK D. CUMMINGS, PORTLAND, ME.

Mr. TUCKER. Will you please state your name and your residence?

Mr. CUMMINGS. My name is Frank D. Cummings; residence, Portland, Me.

I am here at my own initiative and at my own expense. I represent no one directly but myself, although I believe indirectly I represent the views of a vast majority of the people of this Nation.

You are confronted, gentlemen, it seems to me, with a very strange and anomalous condition. With every other form of gambling which you can name banned by law, how in Heaven's name can you justify the greatest gambling institution on the face of this earth.

Of course, gambling is a very ancient practice. I believe that Holland was the first nation to attempt to regulate what they termed "dealing in futures." Something like 500 years ago they recognized the evils attending that practice. About 100 years later, I think, England took some steps along the same line.

Some of the gentlemen who have preceded me have mentioned the various attempts in this and other countries to control this evil.

But money has always had a great power and influence in this world; and there have been people to either prevent or repeal, or render ineffective, nearly all of the attempts at regulating this evil.

To-day the lottery is banned by law. The wheel of fortune is illegal. All sorts of gambling devices, whether they be slot machines, or whatever they may be, are denounced, and those who use them are punished under the law. If men gather in a room and play poker they are liable to be raided and brought into court; and the next morning, under the names of "Richard Roe," "John Doe," and various others, they pay their fines and go home. [Laughter.]

Even gambling with dice is prohibited by law. And many of the methods that were formerly carried on—in church festivals various games of chance were formerly carried on—but that is no longer a legal practice.

But in spite of all that, we are confronted with this situation in regard to the stock exchanges.

I know that an evil, a custom, that has grown up during our whole life, and the lives of our fathers and our grandfathers, seems to have become a sort of accepted fact, and people do not seem to consider the merits and the quality of that thing so much. Even if they recognized it as an evil, it seems that they have almost accepted the idea that it is something that has to be.

I think it was Alexander Pope who said:

> Vice is a monster of so frightful mien
> As to be hated needs but to be seen;
> Yet seen too oft, familiar with her face,
> We first endure, then pity, then embrace.

And it seems to me that something of that condition has its effect upon this situation to-day.

Mr. MICHENER. Have you read the bill before the committee?

Mr. CUMMINGS. Yes.

Mr. MICHENER. I think the committee would be more interested in a discussion of the bill than a general dissertation on the subject of gambling.

Mr. CUMMINGS. Yes.

Mr. MICHENER. I think we all appreciate that situation. But we are dealing here with specific facts and not generalities. If you will confine your discussion to what is before the committee we will appreciate it.

Mr. CUMMINGS. I think, Mr. Chairman, that the principle underlying this whole thing is before the committee, and a discussion of it is very practical; that is my opinion.

I have read Mr. Whitney's address in support of short selling. I noted that in 1931, on May 25, when he says the short interest reached the peak—when there were 5,589,000 short shares uncovered, he sought to minimize the effect of that, because it was merely, as he said, two-fifths of 1 per cent of the total number of 1,300,000,000 shares listed on the stock exchange.

If it was a small item, and if it is generally a small item, I do not know why he should so strenuously oppose doing away with what is a small matter.

Mr. YATES. Do away with what? I did not get that last.

Mr. CUMMINGS. Doing away with what he would consider a small matter—that is, the small volume that the short selling is of the market.

He does not, as you will notice, take the total number of short sales that have taken place at any time. This was merely the number that had not been covered.

And I want to call your attention to one other thing in connection with that: His argument that short selling is a benefit—that it is beneficial. Well, he reminds me of the story of the man who died and went up to the Pearly Gates and rapped. And St. Peter said, "Who is that?" And he said, "A Wall Street broker." "What do you want here?" "I want to come in." "What have you ever done that you should come in here?" "Why," he said, "one day on the Street I met a very destitute and feeble old lady, who had lost all her savings in one of the failed banks. She was absolutely without means, and I gave her a cent."

St. Peter said to the recorder, "Did he do that?" "Yes; he said he did." "What else did you ever do?" The man said, "I met a workingman who had had a home of his own and a family, and he had been trying to pay for that home, but the depression put him out of employment, and he could not meet his obligations, and he had come to the city to try to find work to get bread for his wife and children. He was accompanied by a farmer, one of the thousands and thousands who had lost their farms in the same way."

"Well, what did you do?" "I gave him 2 cents." "Did you ever do anything else to benefit humanity?" "Why, I placed a great many short sales on the market for various people." "Anything else?" "I do not recall anything else."

And St. Peter said to the recorder, "What shall we do with this man?" And the recorder said, "Give him back his 3 cents and tell him to go to H———." [Laughter.]

I am unable to understand the point of view of a man that thinks that he could leave the regulation of what is generally admitted to be an evil to those who are conducting the evil; I can not quite understand that.

I think it would be just like the case where the wolf made a trade with the shepherd. The wolf was being hard pressed, and he had doubts about his being able to keep his life. So he sought out the shepherd, and asked permission to have all the dead sheep. And the shepherd granted it.

But it was but a short time before the flock of sheep began to diminish. And investigation showed that the wolf had very soon arrived at the point where he regarded the sick sheep as dead—and when he was still further oppressed, he began to regard the well ones as sick. [Laughter.]

Do you not leave the regulation of this matter to the wolf of Wall Street. If you do, you will get just the same results—you will have nothing effective done.

Now, this short selling, this gambling in stocks, is either right or wrong. It is either beneficial or injurious. If it is injurious, for Heaven's sake stop it.

I want just for a minute to call your attention—I wish you would picture in your minds the position of this country up to and into 1929—the most prosperous period that this or any other country ever enjoyed. Labor was employed at good wages. All industry was thriving. Profits in industry were the best ever known—as is proven by the constantly increasing returns on income taxes and the annual increase in American millionaires.

But a cloud came over that situation. And I want, as it occurs to me right here, to call your attention—and especially the attention of any one who disagrees with me—to the thought that this depression was produced by stock gambling.

I want to call the attention of the committee to two men who may be considered unbiased—men who are not citizens of this country. I refer to the head of the Bank of England, who on his trip here, publicly attributed our condition to what had taken place on the stock exchange. And also a similar expression by the editor of the Efficiency Magazine of London, who, in an address to the business men of America, made similar statements.

Then, only the other day, Winston Churchill, in an address here, in Constitution Hall, stated that prior to the crash in the stock market, this country had come the nearest to solving the difficulties between producer and consumer than had ever been done. These men recognized what is the cause of our condition, and recognized this gambling evil.

Mr. TUCKER. Mr. Cummings, I dislike to interrupt you; but the hour has come when we have to go to the House.

Mr. CUMMINGS. Well, Mr. Chairman, it may be that, to men who confine themselves simply to stock statistics, that it is more important and that there is no need of discussing either the moral principles that underly this thing, or the facts as they exist as a result of what has been done——

Mr. MCKEOWN (interposing). I think, perhaps, you do not understand. It is just a question of time. We have to go to the House of Representatives at 11 o'clock. We are not permitted to sit after the House meets. It is not that we are not interested in what you are saying at all; but it is an unfortunate situation.

Mr. CUMMINGS. Well, I would like to have completed my statement.

Mr. MCKEOWN. Would you like to extend your remarks in the record of these hearings? You might be given that privilege.

Mr. CUMMINGS. Well, if I thought the committee would give it any attention, I would write out and submit a statement in order that it might be put in the record.

Mr. MCKEOWN. I am sure the committee will be very glad to consider it.

(The statement, submitted by Mr. Cummings, is as follows:)

To the Chairman and members of the Judiciary Committee.

GENTLEMEN: Continuing my statement before you to-day allow me to state that in my judgment, the way to prevent the evils arising from transactions on our stock exchanges is to prohibit those practices from which those evils arise.

Mr. Whitney, the president of the New York Stock Exchange, says that short selling is beneficial and that bear raiding is not sanctioned by the stock exchange. If that be true, and none of the short selling can be classed as "bear raiding," then there is all the greater need of prohibiting short selling. The fact is that it would be as difficult for Mr. Whitney to tell when short selling became bear raiding, as it is for him to tell when a pig becomes a hog. The remedy is for the New York exchange, and all other bodies of like nature, to stop raising pigs.

Not only every short sale, but every long purchase, or let us say every transaction which does not and is not intended to be a completed transaction with transfer and actual delivery of the thing purchased or sold, is simply a bet on the rise or fall of the market, and the money put up as margin is the ante or money deposited as security with the one who places the bet.

Mr. Whitney asserts that if short selling was stopped they would have to close the stock exchange. This I do not believe. I do, however, realize that it would make great changes. It would result in an honest marketing of securities. No one can reasonably doubt that there would be a place where the hundreds of billions of dollars worth of stocks and bonds would be offered for purchase or sale, or such part of them as were on the market, every business day in the year.

Even if it be true that to prohibit gambling on the exchange would cause the closing of the exchange, it should in no wise deter such prohibition. The evil results are so great that the door through which the evil enters should be closed as tightly as a door to the United States Treasury vaults, and the combination by which it could be opened be sunk in the deepest sea.

I desire to call attention to the date at which Mr. Whitney begins his statistical exhibit, meager and incomplete as it is. Note, please, that he gives no statistics of short selling in 1929, none in 1930. Not until May 25, 1931, does he offer anything in even pretended explanation of short selling.

On what took place in 1929 when money was drawn from every section of the United States to be used either as margin or for loaning at high rates of interest, Mr. Whitney supplies no information, notwithstanding the fact that it was the crucial period when brokers' loans reached the stupendous sum of $8,500,000,000 and the decrease in the value of the stocks listed on the New York Stock Exchange amounted to $26,000,000,000.

The $8,500,000,000 represents the amount that brokers had loaned those for whom they had placed the bets, and does not include the money advanced by the principals as margin or security for those bets.

Do you wonder that the time came when more money was not forthcoming to replenish diminishing margins, thus forcing liquidation and still further declines?

Do you wonder that as commodity prices began to decline and industrialists became fearful that their products would not, when produced, bring the cost of production, they curtailed production, thus bringing on unemployment? Do you wonder that those who still had money hid it away, afraid to either invest it or keep it in a bank?

Gentlemen, our whole trouble arose as a direct result of gambling on the New York Stock Exchange.

Gentlemen, it hurts me, it humiliates me, to know that such things are done in my country. It makes me ashamed, and I do not like to be ashamed of my country, as I must be when I am ashamed of the things which it permits.

When a murder is committed by parties then unknown, the first questions that justive asks are regarding motive and opportunity. When it is established that a certain person had both motive and opportunity, justice places its hand on that person's shoulder and says, "Thou art the man."

That the dreadful conditions prevailing in this country were brought on by the stock gambling in Wall Street is fully established. The evidence in the case would convict an individual of a capital crime. Other things have been done that added to the distress, but they were simply accessory after the fact.

It will be urged by some that if the thing complained of is due to the cause to which I here attribute it, that it is not within the power of the Federal Government to abolish it. This I deny. When we behold the financial and fiduciary institutions in such danger of complete collapse that the Federal Government proposes to issue bonds to the amount of $2,000,000,000 if necessary to save them from destruction, when all business and all industry is paralyzed, when the homes and farms of our people are going under the hammer because they can not pay interest and taxes, when 8,000,000,000 workers which with their dependents represent approximately one-fourth of our population, countless numbers of whom are suffering for the necessities of life, the Federal Government is not left impotent and unable to abolish the cause of those conditions. Under the general-welfare provision of the Consitiution it has ample power to do that, and it will be done if Congress will enact the necessary legislation.

Respectfully submitted.

Yours truly,

FRANKLIN D. CUMMINGS.

Mr. SABATH. Mr. Chairman and gentlemen, realizing the conditions, let me say that I have devoted about two years and a half of study to this situation, and to the various bills. I desire to be heard by the committee; but, of course, I realize that we are obliged to be on the floor of the House now. When can I be heard?

Mr. TUCKER. We are going to fix a time in executive session immediately on adjournment when we will hear Professor Stagg and you, Mr. Sabath. I do not now know what day that will be.

Mr. SABATH. I think I have some very valuable information for the committee—statistics and reports, and so on, which are all unbiassed, and furnished by men who are not hired or paid by anybody.

Mr. TUCKER. Of course, we want to hear you, Mr. Sabath; and you are entitled to be heard. But we have been very much embarrassed by the fact that gentlemen have come here from a distance, and we have heard them first.

Mr. SABATH. Yes, Mr. Chairman; I have been willing to give way to them.

Mr. TUCKER. I understand that.

You will be informed, gentlemen, as soon as we can, when the committee will hear you.

(Thereupon, at 11 o'clock a. m., the subcommittee went into executive session, at the conclusion of which it adjourned until Wednesday, February 24, 1932, at 10 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE OF THE COMMITTEE ON THE JUDICIARY,
Wednesday, February 24, 1932.

The subcommittee met at 10 o'clock a. m., Hon. Henry St. George Tucker presiding.

STATEMENT OF RICHARD WHITNEY, PRESIDENT NEW YORK STOCK EXCHANGE

Mr. TUCKER. The committee will be in order. Mr. Whitney, will you give your name, whom you represent, and your residence?

Mr. WHITNEY. My name is Richard Whitney. I am president of the New York Stock Exchange; address 11 Wall Street, New York City.

Mr. TUCKER. Proceed.

Mr. WHITNEY. Mr. Chairman and gentlemen of the committee, I have examined with care the four bills pending before you. I understand that they are H. R. 4, introduced by Mr. LaGuardia, which, in effect, requires stock exchanges to secure and publish promptly information in regard to short selling in securities of banks and of corporations engaged in interstate commerce. This bill further gives broad powers to the Federal Trade Commission to suspend short selling in any particular security and to prohibit any corporation which permits its securities to remain listed on a stock exchange which does not comply with the act from engaging in banking or interstate commerce.

H. R. 4639, introduced by Mr. Sabath, which, frankly, prohibits all short selling, and H. R. 4638, likewise introduced by Mr. Sabath, which prohibits the transmission or communication in interstate commerce or through the mails of any false information tending to affect the price of securities listed on any stock exchange.

H. R. 4604, introduced by Mr. Kelly, prohibits the transmission through the use of the mails or in interstate commerce of any offer or information in regard to a contract respecting the purchase or sale upon credit or margin of any stock where it is intended that such contract shall be settled on the basis of quotations or prices and without any bona fide receipt or delivery of such stock.

I will, in a subsequent part of this statement, take up some of the particular features of these bills, but, with the permission of the committee, I would like first to discuss the general question of whether short selling of securities is, as I believe, a necessary and useful practice or whether it is, as so many persons assert, a destructive abuse which can not be justified on any ground.

Let me make clear the mechanics of a short sale on the stock exchange. I have read the testimony of the witnesses who have already appeared before this committee and, to my surprise, it was apparent that some of them did not understand how a short sale was made on the stock exchange. It is not surprising, therefore, that they had an erroneous impression of the effect of short sales on the price of securities.

If a person orders his broker to sell 100 shares of a stock short, the order is transmitted to the floor of the exchange and is executed in the same way as any other selling order. In fact, the broker who buys the stock is not aware he is purchasing from a short seller. Until recently when the exchange directed that all selling orders be marked so as to show whether they were for long or short account, it often happened that the selling broker did not know whether his customer was making a long or a short sale. This was due to the fact that until the time for the delivery of the stock the customer did not have to disclose whether he would deliver his own securities

or wished his broker to borrow securities for the purpose of completing the contract.

In the vast majority of short sales the customer asks his broker to borrow the stock for him and to deliver it against the sales contract. The brokers borrow stock from persons who either own it outright or hold it on margin. For convenience, the brokers who desire to lend or borrow stock meet on the exchange immediately after the close of the market and, depending upon the relative supply and demand, a price is fixed for the lending transaction. This price may consist in an interest differential or in an actual premium over and above all interest. Assuming, for the sake of illustration, that a stock is lending at a small premium, say, a one-sixteenth, the broker who borrows agrees to pay the lender as compensation for the loan $6.25 per day for each 100 shares of stock borrowed. In addition, he must secure his borrowing by depositing with the lending broker the full market value of the stock borrowed.

As I have already pointed out, the borrowing of stock is therefore the counterpart of the borrowing of money against collateral security. In one case money is borrowed and the obligation is secured by stock, the compensation of the lender being fixed at some rate of interest on the amount loaned. In the other case, the lender of the stock is secured by the deposit of its market value in cash and his compensation is determined by the amount of the premium which the borrower agrees to pay for the loan. Both transactions necessarily involve credit and I personally, can not see why it is wrong for a man to borrow stock if the borrowing of money is permitted.

You may well ask at this point why the owners of stock are willing to lend to short sellers when the latter can make a profit only by a decline in value which would be contrary to the interest of the lenders. The answer is simple. The compensation which short sellers pay for the loan is sufficient to induce lenders to engage in the transaction. Furthermore, this willingness to lend stock is not solely due to a desire for immediate return, but is based, in part at least, upon the knowledge of many hard-headed owners of securities that the value of their property depends upon the existence of a market. They appreciate that by facilitating the market for securities they are in fact protecting the liquidity and value of their property.

I am aware many people believe that the only stock available for loans belongs to margin customers and that brokers force their customers to agree that stocks can be loaned in order to furnish a supply of securities for short sellers. In fact, Mr. Perkins, who recently appeared before this committee, said:

> The short seller sells what he does not own and makes delivery from the "floating supply" of shares created by the exchanges for that purpose through the requirement that members may lend to short sellers all the shares carried on margin for customers.

That statement, in so far as it accuses the exchange of requiring the loan of long stock is wholly untrue. The exchange has no such requirement. On the contrary, it has always held that brokers have no right to lend stock belonging to margin customers without

express permission. This permission is revocable, so that even if it is once given, it can be revoked at any time.

I mention this matter specifically because in the last few months misstatements in regard to the lending of margin stock have become more and more frequent. Last week the governing committee of the exchange, realizing that the popular misconception had grown so great as to disturb even many intelligent persons, decided to make its position in regard to the lending of stocks absolutely clear. It, therefore, ruled that the consent of customers to the lending of stocks could not be incorporated in the usual form of agreement which customers sign when they open brokerage accounts. It required that these consents be incorporated in separate documents so that customers would clearly understand the nature of the power they were vesting in their brokers. This resolution emphasized by the fact that such consents were revocable and authorized the committee on business conduct, in its discretion, to require members of the exchange to remind their customers of their right of revocation at reasonable intervals.

I trust you will pardon this digression from the explanation of a short sale which I was giving you, but, frankly, I felt that I must bring to your attention in a forceful manner the various misstatements which have been made in regard to the lendings of margin stock. To return to my subject, a short sale is executed, as I have said, in the same manner as any other sale. The stock which is to be delivered on the contract is borrowed and when the day for delivery comes the original contract is completed by the actual delivery of the borrowed stock. The market value is deposited with the lending broker and the transaction is then complete, save only for the deposit of margin with the selling broker. Short sales, like long purchases, must be margined. The amount of margin varies from time to time. Smaller margins may be sufficient in times of stability, while larger margins are necessary and required in periods of uncertainty or of great speculative activity. The amount of margin now required on short sales is substantial, and almost equal to the highest margin required on long stock during the bull market of 1929.

Short selling has been a regular feature of all organized security markets from time immemorial. Security markets are created by the desire of people to invest and speculate, and speculation necessarily includes speculation for rising prices as well as speculation for declining prices. I realize that many people believe that the short seller, because he believes prices will decline, is purely a destructive influence and, therefore, an evil. This simple conclusion fails to take cognizance of the essential part which the short seller plays in maintaining an equilibrium for prices. If everybody was solely interested in seeing stocks rise, the upward tendency would continue until a fantastically high level of prices was reached and then suddenly there would be no purchasers whatsoever. As a result, the market would fall precipitately from high to extremely low levels and there would be no transactions on the descending scale. The economic function of short sellers in a market for securities is to provide buying power even when prices are declining. Short selling may also tend to prevent prices going to absurd heights during periods of inflation. Economists agree as to the necessary and

useful function of short selling, but when prices are declining it is extremely difficult to convince people that these students of economics are right. Since 1929 many of our people have been so influenced by their personal losses that they can not dispassionately consider the facts of the case. Let me, however, remind you that in spite of the drastic deflation of security prices, the New York Stock Exchange has maintained a market for securities which has allowed the holders of stocks to sell and realize cash for their property. Even if the amount realized is less, and very much less, than it would have been if these people sold in 1929, it is, nevertheless, an outstanding achievement that our market has stayed open and maintained the liquidity of securities.

If there had been no short selling of securities, I am confident that the stock exchange would have been forced to close many months ago. It was the willingness of people who had sold short at higher levels to buy when prices were breaking that helped to maintain the market. We have avoided the fearful consequences which would have necessarily resulted if securities had become unsaleable. If short selling had been forbidden, the course of the speculative movement in stocks would have been similar to what occurs when there is speculation in property which can not be sold short. The most common and the simplest example is undoubtedly a land boom. We have had many of them and in all parts of the country. One of the most recent and most dramatic was the land speculation in one of our States a few years ago. The price of real estate rose rapidly until people were freely paying for undeveloped lots far from any center of population prices which would have been appropriate for property on the busiest streets in our larger cities. Finally, after excessive prices had been reached, there was a sudden cessation of confidence in the future of this real estate. What happened? Almost immediately the market for real property ceased entirely. It was not a question of whether property which had sold for $100,000 could be sold for 25 per cent or 50 per cent of the so-called value, it was a question of whether a buyer could be found at any price. The resulting crash in value was appalling. Everybody who had an investment in these lands found that he had lost not only a large part of his capital but also the ability to realize cash for what remained. From a period of the greatest activity in the buying and development of real property which, in turn, had induced great business activity, the whole State was plunged into a depression far more complete and enduring than anyone could have imagined.

Without short selling, the stock market would have taken the same course after the boom of 1929. If that had occurred, the consequences to this country would have been truly disastrous. Enormous amounts of credit were based upon the value of securities. In round figures, there was $8,500,000,000 loaned to brokers, and, in addition, a substantially equal sum loaned by banks to individuals upon security collateral. Because the stock exchange remained open and securities could be bought and sold, albeit at lower prices, this vast mass of credit has been, in large part, liquidated. To-day, loans to brokers are only about $5,000,000 and bank loans to customers upon security collateral have been reduced to about $5,000,000,000. If this huge total of loans had become frozen and, because of the absence of a security market, could not have been

reduced, our entire banking system would undoubtedly have been most devastatingly affected. That calamity, at least, has been spared us. As a practical man who has been watching the course of the security market for years, I trust you will believe me when I say that the market for securities could not have been maintained if short selling had been forbidden.

I know that many people disagree with the statements I have just made and would like some mathematical or other proof of the truth of my conclusions. Most of the statistics gathered by the exchange in regard to short selling have already been published. I submit, for the use of the committee, not only the compilation showing the detailed short transactions from May 25 to November 30, 1930, but also two supplemental statements covering the periods from December 1 to December 31, 1931, and January 1 to February, 1, 1932. I also submit a chart on which is plotted graphically the total number of shares composing the short interest, a stock price index and since September 26 the percentage of the daily in-and-out short sales. These statistics do not prove conclusively that there is any direct relationship between the size of the short interest and the price of securities.

Do you care to have those charts in front of you?

Mr. CELLER. I would like to see them.

Mr. REDMOND. I will pass them around.

Mr. OLIVER. Why can not you put the letter "S" on the ticker after a transaction so that the public will know, after a great number of sales, how much is short and how much is long?

Mr. WHITNEY. I think it could probably be done, except for the fact in a great many daily transactions it would show that the sale has been a short sale, where there is none now, and as against the fact that where a long purchase is made no record of that is made, whether for margin or otherwise.

Mr. OLIVER. The long purchase would be the one that was not labelled "S."

Mr. WHITNEY. But not showing whether it was a speculative or investment transaction.

Mr. OLIVER. No. You can hardly tell that without knowing. That was an interesting point. You had stopped there in your statement when I took up that question with you.

Mr. WHITNEY. All right, sir. I will attempt to answer anything I can.

Mr. OLIVER. That is all right.

Mr. WHITNEY. Shall I proceed, Mr. Chairman?

Mr. TUCKER. Yes.

Mr. WHITNEY. This is not surprising because short selling is not the only factor which affects the price level of securities. In fact if these statistics prove anything they prove that, contrary to the popular theory, short selling is not a dominant factor in the stock market.

No one can look at the trend of stock prices during 1931 without appreciating the tremendous effect of the dramatic events which occurred in the course of the year. The chart before you shows the volume of the short position during the year. In May the Austrian Credit-Anstalt, one of the largest and most important banks in Austria, failed. This was the first of the European banking difficulties and affected some of the most important banks in Germany and Holland. It may have been the cause of the very large short interest which existed on May 25, when our statistics were first gathered. From May 25 to July 3 the price level remained practically stationary until June 17 when the announcement of President Hoover's suggestion in regard to a temporary delay in reparation payments made people believe the critical situation of Germany would be obviated. For a period of about 10 days the utmost confidence prevailed and stock prices rose, but shortly thereafter the difficulties encountered in securing the approval of other creditor powers to the German relief program began to cause doubt and prices started to decline. This decline was accentuated by the grave crisis which developed in Germany. On the chart you will see that, commencing on July 3, the price of securities definitely turned downward. By July 13 the withdrawals of gold from Germany brought about the failure of one of its most important banks. On the 14th the German Government proclaimed a bank holiday which, in effect, was a moratorium. The immediate reaction caused by this news was a further decline of prices, because it was generally known that a large volume of German acceptances were held by American banks and no one could foretell what effect the sudden illiquidity of these assets would have on our credit structure.

Mr. OLIVER. Does this show the total number of the short interest, including in-and-out sales, or are they excluded in that?

Mr. WHITNEY. They are excluded except on the last two. Those figures were not compiled or asked by us until September 21st.

Mr. OLIVER. Will you explain later on what effect the in-and-out sales have on the trend of prices?

Mr. TUCKER. Proceed.

Mr. WHITNEY. I need not describe in detail the elaborate negotiations which ultimately brought about the socalled standstill agreement in regard to German paper held by foreign banks, but this incident demonstrates the danger of any action which makes short-term banking assets illiquid.

The price level continued to decline until the first week in August and then rose, probably due to the announcement that the United States Steel Corporation had decided to cut the salaries of its officials. Throughout the rest of the month both the price level and the volume of the short interest remained relatively unchanged. In the early part of September a rapid decline in stock prices commenced. Far from being accompanied by an increase in short interest, there was an actual decline between September 11 and September 18 of approximately 240,000 shares. This price movement was clearly caused by the growing difficulties of the Bank of England. Day after day our newspapers reported the withdrawal of large amounts of gold from the British market. It became more and more apparent that there was a real possibility of England going off the gold basis. Even resignation of the Labor Ministry and the formation of the coaliation National Government at the end of August, was not able to stem the tide of fear in regard to the soundness of the British currency. On the night of September 20 the British Cabinet announced it would immediately appeal to Parliament to suspend gold payments. It was in the face of this emergency, which brought

about the closing of all of the most important stock exchanges of Europe, that the New York Stock Exchange imposed its temporary two-day ban on short selling.

I have already described, and particularly in my address at Hartford last fall, the reasons which actuated the governors of the exchange to take dramatic action in the face of the sterling crisis. Frankly, we felt that it was an alternative to closing the exchange. Only twice before in our history has any such action been necessary. In 1873 the exchange was closed for a few days. In 1914 for several months. We knew from our experience at the outbreak of the war that closing the exchange would not prevent a decline in security prices. When the exchange closed upon the announcement of the World War, members of the exchange were forbidden to buy or sell securities at lower prices than had prevailed at the time of closing. Almost immediately informal security exchanges sprang up in offices and even out in the streets. Transactions were made in the so-called "gutter markets" of August, 1914, at prices far below the closing prices on the exchange. We felt last September, that if the exchange were allowed to close there would be no certainty as to when it would be able to reopen and that the freezing of collateral security loans would be disastrous.

Many of the people have wondered why the governors of the exchange concluded that the banning of short selling would permit the market to stay open. The answer, of course, is that we were aware of the existence of a short interest of approximately 4,000,000 shares. Those who were short were bound to realize that the prohibition on short selling was an indication the exchange might close. They would attempt to cover their contracts before the exchange closed, because unless they did so there was no certainty as to when they would have an opportunity of settling their open contracts. That the conclusion of the governing committee was sound has been proved by what took place on September 21 and September 22. The existing short interest did buy stocks. Our statistics show that 280,000 shares were covered on September 21; nearly 800,000 shares on September 22; and more than 330,000 shares on September 23; with a declining or steady market existing on the first two of these three days, but a sharp rise occurring on the third day when the ban on short selling was lifted.

Many students of economics have apparently failed to understand what happened during these critical days. In fact, Mr. William Trufant Foster, in an article in the Atlantic Monthly entitled "Selling the United States Short," said, in part:

> To meet this situation, the governing committee decided to suspend short selling. "In the opinion of the committee, a sudden ban on short selling would be likely to force covering by those who were short."
>
> Here is reasoning as curious as that of the Mad Hatter; it will find a place, no doubt, in the new book which is developing out of current economic discussions, called Alice in Blunderland. Mr. Whitney's first premise is that liquidation, not short selling, is the cause of declining stock prices. He then declares that further liquidation is inevitable. He concludes that a ban on short selling "would be likely to force covering by those who were short."
>
> What kind of logic is this? Why should anyone who has sold what he does not own, in the hope of buying it later on at a lower price, be forced to cover if further liquidation is inevitable? Why not simply wait for the inevitable liquidation to take place, and then reap an inevitable profit by buying at the resultant lower price?

Mr. Foster is not sufficiently familiar with the operation of our security market to understand that the closing of the exchange would prevent the existing shorts from taking advantage of any further decline in prices. Those who were short held only contracts of members of the exchange. It was obvious that if the exchange had closed in September, 1931, a prohibition, like the one used in 1914, against members buying or selling at lower prices would have been imposed.

Mr. CELLER. That was called minimum price.

Mr. WHITNEY. Yes. Those who were short realized, therefore, that if the exchange closed they would hold contracts of members which could not be settled except at or above the existing price level. No further decline in security prices could increase their profits. In the meantime they ran the risk that the closing of the exchange might bring about the insolvency of brokers, in which case any existing profits might be lost. It was the part of wisdom, therefore, for them to buy stocks and to take their profits. The logic of the governing committee, which Mr. Foster criticizes, was sound, as the events have proved, and was based upon the actual knowledge of past experience. The governing committee of the exchange consists of 42 men, who are or have been actively engaged in the security business for many years. In the aggregate, their experience covers not one but many panics and crises. To those who had lived through the experience of 1914, there was no doubt that a temporary ban on short selling would bring purchasing power into the market. As I have said before, their experience and judgment were justified by what took place in the next few days.

By remaining open during the English sterling crisis, the New York Stock Exchange assisted the security markets of Europe to reopen. Before the end of the week all of the principal European exchanges, except Berlin, were again in operation and the liquidity of securities throughout the world was reestablished.

It is true, of course, that the price level continued to decline. It declined, not because it was driven downward by further short sales but because the mounting financial difficulties, of which the sterling crisis was only the forerunner, became more and more apparent. It was not until October 5 that the general decline in security prices stopped.

The turn in the tide in security prices occurred on October 6. It was due, obviously, to the intimation of a forthcoming announcement in regard to action by our Government. On October 7 the plan for the National Credit Corporation was officially announced. With various fluctuations, with indicated doubt and hesitation as to how this plan would actually operate, security prices in general rose until they reached a peak figure in the early part of November. During the period the short interest increased, but the relation between the increase in the short interest and the general stability or rising tendency in prices has not been commented upon by those who believe that short selling is the primary cause of declining prices.

During the rest of the year the general tendency of stock prices was downward and the fluctuation of the short interest does not seem to bear any direct relation to the general trend. If we remember what took place during this period, I think we can easily understand why prices declined. The withdrawals of gold from the United

States, the increasing number of bank insolvencies, and the generally unsatisfactory reports of corporations all gave little hope for an early resumption of business activity. In addition, the European situation became more and more complex and the hope which so many persons held in June and July that the problem of reparations would be settled on an amicable basis grew more and more remote.

Mr. OLIVER. Then didn't a lot of these Cabinet officers say that everything was sound, that the stock market would go up?

Mr. MICHENER. We are a judiciary committee, and if the gentleman wants to make a political speech I will ask him to retire.

Mr. OLIVER. Thank you.

Mr. MICHENER. Proceed.

Mr. OLIVER. I did not know you were chairman.

Mr. MICHENER. I am on the subcommittee.

Mr. OLIVER. I will not retire at present.

Mr. MICHENER. Proceed.

Mr. WHITNEY. In January of this year the volume of the short interest increased substantially, but there was no outstanding change in the general level of security prices. At the end of the month prices stood nearly half way between the highest point, which was reached about the middle of the month, and the lowest point, which was reached on the 4th or 5th of January. The announcement of the plan for the National Reconstruction Finance Corporation was well received, but did not bring about any enduring change in price level because its immediate effect on business was problematical. It was not until the recent announcement of the plan for increasing the use of Federal reserve credit that the market responded and the price level showed a substantial advance.

I am afraid this somewhat lengthy reminder of the influence of events on stock prices may have wasted the time of the committee, but, to my mind, it shows very clearly that the oft-repeated statement of the baneful influence of short selling can not be supported statistically. In this connection, however, I notice that one of the witnesses before this committee recently endeavored to prove, by analyzing the action of particular issues, that short selling had a direct effect upon prices. I do not think it will be profitable to examine all the numerous cases which were cited, because he admits that, in many instances, the price level declined at the same time that the short interest was also declining. Clearly, if short selling has a direct and paramount effect upon the price level, then stock prices should rise when the short interest decreases. If stock prices decline when the short interest is declining, the only possible conclusion is that short selling is not a dominant factor.

Let me now pass on to another aspect of this question. It has been alleged, over and over again, that short selling is an evil because it permits concerted action against the market. A number of witnesses have appeared before this committee and have described what they confidently believe to be the destructive tactics employed by short sellers. Mr. Aron drew a distinction between what he called organized short selling, which he considered unjustifiable, and ordinary short selling, which he thought might be legitimate. He endeavored to prove, however, that by attacking pivotal stocks the short sellers might depress the entire securities market. Mr. Perkins quoted an anonymous article in which it was stated: "Everyone

who knows his way around below Fulton Street, knows that 'bear raiding' has always been an accompaniment of every period of liquidation." He implied that these nefariously minded individuals would hurl large blocks of stock at the market and that the declines thus brought about produced liquidation which would carry stock prices to lower levels. That such attempts are conceivable, and may have been actually employed years ago when the volume of transactions on the New York Stock Exchange was extremely small, I think every one will admit; but in recent months such conditions have not existed. My assertion that such crimes have not been committed on the New York Stock Exchange may not convince those who do not wish to study the facts or learn the truth. My statement, however, is based on daily observation of what has occurred on the exchange. Ever since the panic of 1929 the committees of the exchange have been alert to notice any signs of bear raiding. Every questionable case has been investigated. Although the supervision of the market has been more intense during the last year than ever before, we have failed to discover any evidence of organized short selling or of bear raiding. A number of instances which superficially seemed to be bear raids upon investigation were discovered to be only the liquidation of substantial blocks of stock. We have examined with care the accounts of short sellers in an effort to find any evidence that there had been concerted action in short selling. We have found no evidence to support the theory that a small group of speculators have conspired together to drive prices downward.

The exchange has in good faith endeavored to stop bear raiding. I can assure you that all of the governors of the exchange, and most of them are active business men who are present daily on the floor of the exchange, are constantly watching price movement and investigating any decline which seems to be out of the ordinary. Some months ago the committee on business conduct directed that all selling orders be marked so as to show whether they were for long or short account. At the same time the members of the exchange were warned of the penalty they would incur if they participated in short sales which tended to depress the market. This rule had two results. First, it permitted the governors of the exchange to find out, without delay, whether a sale which caused a decline in prices represented short stock or the liquidation of long stock. Second, it caused the members of the exchange to notify their customers that short stock would not be sold at a lower price than the last preceding transaction. I feel confident, therefore, in making the statement that in recent months bear raiding has not existed on the New York Stock Exchange.

Mr. CELLER. Did you examine every suspicious case of bear raiding?

Mr. WHITNEY. Yes.

Mr. LAGUARDIA. I did not get that.

Mr. WHITNEY. Did we examine every suspicious case of bear raiding?

Mr. SUMNERS. Every suspicious case of bear raiding. What aroused the suspicion? What makes them suspicious cases?

Mr. WHITNEY. As an instance, where a man comes in and sells a thousand shares of a stock on a declining price, immediately we will

investigate whether that was for long or short account, and if for short account, immediate action would be taken of a penalizing nature; if for long account, the condition of the market surrounding the making of the sales, and upon that would rest decision as to whether he had executed the order properly or not.

Mr. CELLER. Do you know of any case such as was indicated by Mr. Perkins when he testified that when there were rumors of some difficulty in some corporation, brokers would open their books and allow those who had indulged in bear raiding to see what the short interest was, and if the short interest was great they would continue to spread those rumors? Do you know of any such case?

Mr. WHITNEY. I do not.

Mr. TUCKER. I would remind the committee that the gentleman is not to be interrupted in his statement.

Mr. WHITNEY. Finally, before dismissing the subject of what our short-selling statistics disclose, I wish to refer to the alleged excessive concentration of short sales in particular issues. Computations have been made showing that a particular list of stocks included 50 or 60 per cent of the total short position, and the inference was raised that there is something nefarious and wicked in these facts. Mr. Perkins submitted two schedules showing the total short interest in 20 and 50 stocks on certain particular dates. I have taken the same list of stocks and had a computation made showing the volume of transactions in these stocks on the dates selected by Mr. Perkins. This computation also shows the percentage of transactions in these stocks to the total number of transactions in all stocks on the dates in question. These percentages differ from those shown by Mr. Perkins, but the differences are immaterial. The outstanding fact is that the greatest short positions exist, as one would expect, in the most active stocks. Otherwise, there is nothing either surprising or important in these compilations.

What is important in regard to the statistics of individual stocks is what I have already pointed out in my addresses—the stocks with the largest short interest have had the most orderly markets. I do not wish to waste the time of the committee by repeating statements which are already available in convenient form, but I do think it is important to emphasize again that every stock which has had a large short interest has fluctuated, either upward or downward, in an orderly manner. This well-known result of short selling is what economists have referred to as its "cushioning power." The phrase is unfortunate, because it has led people to believe that the cushion would prevent declining prices. That, of course, is not true. What short selling does, in the face of a declining market, is to prevent quick and wide fluctuations. It causes successive transactions to take place as prices decline and prevents sudden and radical breaks.

Mr. CELLER. Will you tell how that is, just briefly?

Mr. CONDON. He has asked not to be interrupted.

Mr. LAGUARDIA. It is very clear to every other member of the committee.

Mr. CELLER. I do not know that it is clear to the gentleman who has just spoken.

Mr. WHITNEY. I have already referred to the situation which developed immediately after the governing committee imposed a

temporary ban on short selling on September 21. I have cited the example of General Motors and Reading stocks. I can, if the committee is interested, product many other examples of the wild fluctuations which took place that morning before the governing committee relaxed the ban and permitted short selling when it was clearly necessary to prevent disorderly trading. Rapid fluctuations in stock prices and particularly the absence of bids or offers for stock disturb the whole financial community. It has been the constant endeavor of the exchange to provide continuous and orderly markets. Just how important this is can best be illustrated by what took place in the opening days of the panic of 1929. At that time the short position was relatively small and when the panic started there were comparatively few persons who had sold short at higher levels and were ready and willing to buy stocks. In spite of the buying power which was injected into the market by the banking group, there were numerous stocks which broke 5 to 10 points between sales. In fact a phrase was invented to describe these phenomena, they were called "air pockets." In the wild rush of trading it was not possible to avoid these unwarranted fluctuations, and, therefore, the public became disturbed. The governors of the exchange had, in some instances, to take drastic action to prevent declines of 20 and 40 points. For a number of days even very important stocks, such as Corn Products and Reynolds Tobacco "B," did not sell at all because the only bids were so far below the price of the last transaction that the governors of the exchange did not feel the price would reflect the true market value and therefore prohibited the opening of these stocks. If a rigid ban on short selling is imposed, the fluctuation in prices is bound to be more rapid and price changes between successive transactions may be so far apart as to destroy all semblance of a market. If this occurs, the closing of the exchange may follow and with it a freezing of all collateral security loans which will affect our entire credit system.

It is often charged that one of the indirect and dangerous results of short selling is that it engenders depressing rumors which disturb public confidence. These rumors, it is alleged, are put out by short sellers in the hope of bringing about a decline in prices. As far as I know, nobody has ever been able to prove that any such conspiracy to disturb public confidence actually existed. The exchange has long anticipated that a connection between short sellers and rumors might be imagined and it has taken unusual precautions to prevent such a possibility. We have investigated every case in which such a relationship seemed possible and we have been unable to find convincing evidence that willfully false stories as to business conditions or the condition of any particular company have been circulated by short sellers for the purpose of depressing prices.

The exchange, however, has not limited its activities to tracing rumors which were already in circulation. It has at different times and more or less constantly supervised the opinions expressed by members of the exchange not only in their market letters, but also over their wire connections. In one case where statements with regard to the condition of a company were sent over a private wire system and the sender had a short position, but I must say in fairness to him only a small one, a most elaborate investigation was

made. This disclosed that the statement, which in general was to the effect that the published accounts of a particular company were not accurate and therefore could not be relied upon, was absolutely true. The information on which the member of the exchange acted had not been secured, as some people might suppose, by inside or unfair mean, but was the result of a careful analysis of the statements which had been published by the company. Therefore, instead of attempting to destroy existing confidence, this man was calling to the attention of his customers who were stockholders of the company, the untruthful and misleading statements which the management had published. Surely, a case of this kind can not be considered as one which warrants condemnation. I mention it only to give you an indication of how the exchange has supervised the possible connection of rumors with short selling.

Furthermore, in regard to rumors, we must always remember that many of the statements which were made months ago about the failure of business to revive and the poor earnings of corporations, have been more than justified. I utterly condemn the circulation of false rumors. There is no justification for deliberately attempting to disturb public confidence in our institutions. But the right of free speech must be preserved, and a man should be able to express his honest convictions in regard to economic conditions even if his conclusions are not optimistic. The depression can not be cured by falsely hopeful statements or by concealing or minimizing the facts in regard to existing conditions. I do not doubt that many persons have been accused of circulating depressing rumors when they were giving their honest opinions about the real condition of business. There is no justification for assuming that all depressing statements were maliciously made by short sellers. There is certainly no evidence that short selling has created rumors or that the prevention of short selling will stop them.

May I turn now to a consideration of the particular features of the bills pending before the committee?

H. R. 4638, which makes criminal the willful transmission of false information tending to affect the price of any security listed on a stock exchange, is a bill which should find support among all fair-minded persons. I suggest for your consideration, however, that the present form of the bill leaves something to be desired. If it is criminal to willfully disseminate false information about a security listed on a stock exchange, it seems to me it should be equally criminal to circulate false information about securities which are not listed on stock exchanges. There are many stocks of great importance which are dealt in only "over the counter." This is particularly true of the shares of banks and the stocks of insurance companies. Certainly, these types of securities deserve the protection of such a statute as much as the securities dealt in on stock exchanges.

H. R. 4639, which in so many words prohibits short selling is, from the point of view of the New York Stock Exchange, fundamentally unsound. As I have said above, we believe short selling is necessary for the maintenance of a security market and this bill, if it is constitutional and effective, might force the closing of the stock exchange. I am advised by counsel, however, that the proposed bill is unconstitutional.

H. R. 4604 prohibits the use of the mail for or the communication in interstate commerce of information in regard to contracts for the purchase upon credit or margin of shares in any corporation when such contracts are intended to be settled without a bona fide receipt or delivery of stock. This bill seems to be aimed at "wash sales" or gambling transactions and if this is so I believe that there is already existing legislation, both State and Federal, to prevent any such evil. At least in the State of New York "wash sales" are criminal and in addition are forbidden by the constitution of the New York Stock Exchange. In a number of instances, where members of the exchange have even indirectly participated in such transactions, the most severe penalties have been inflicted. Mr. Kelly's statement before the committee at the last hearing seemed to indicate that he thought this bill would prevent short selling. In this I think he is mistaken. As I have described above, a short sale, at least on the New York Stock Exchange, is completed by an actual delivery of securities. I mention this matter so the committee may clearly understand that the present form of this bill does not in any way regulate or prohibit short selling.

H. R. 4, while not directly prohibiting short selling, requires publicity and vests in the Federal Trade Commission power to prevent short selling should it for any reason determine that the circumstances require such action. In view of the importance of this bill, I trust the committee will allow me to discuss its provisions in detail. The first two sections are devoted to a title and definitions. The third section contains a number of conclusions of fact which are obviously intended to lay a foundation for Federal jurisdiction over what otherwise seems clearly an intrastate activity. As to many of these conclusions, no evidence has been adduced before this committee which would warrant any such findings. I do not propose to take the time of the committee to analyze the testimony given by the proponents of these various bills, but I beg of you to remember that, aside from expressions of opinion, quotations from anonymous writers and individual interpretations of the statistics issued by the New York Stock Exchange, no actual evidence based on knowledge has been submitted to this committee. As against the guesswork of persons who, admittedly, are not in touch with the day-to-day transactions on the exchange, I submit to you actual facts and figures and the judgment and opinion of the exchange itself which is predicated on intimate knowledge of actual conditions.

I will not take the time of the committee to analyze all of these various conclusions, but let me point out that the statements contained in the last two sentences of this section are certainly not based on fact. The next to the last sentence commences "The arbitrary and abnormal decline in prices produced by short sales produces needless liquidation * * *." I submit that there has been no proof that short selling has arbitrarily produced abnormal declines in prices.

The last sentence begins: "Such short sales of securities constitute an unnecessary practice which obstructs, burdens, and endangers banking and commerce * * *." The only evidence before this committee indicates that short selling is a necessary and not an unnecessary practice. This testimony has been adduced not only

by the New York Stock Exchange, but by students of economics and even by the proponents of the bill. Mr. Aron distinguished between organized short selling and ordinary short selling. The declaration in the bill is that both kinds of short selling are unnecessary. Mr. Aron indicated that he did not feel that this was necessarily true. Furthermore, the bill itself, in the next section excepts short sales made by odd-lot brokerage houses. It is difficult for me to reconcile the declaration in section 3, that short selling is an unnecessary practice, with the exception in the very next section which can be justified only on the ground that the practice is necessary for the maintenance of a substantial part of the security market.

Section 4 provides that no short sale (except only those made by odd-lot houses) may be made on a stock exchange unless the sale is accompanied by information which will disclose the names and addresses of the buyers and sellers, the kind and amount of stock sold and the names of the brokers engaged in the transaction. It further provides that the stock exchange each day shall, at the close of business, cause a faithful summary of the above statements to be prepared, and to be posted at the place of business of the exchange and to be published in a local newspaper of general circulation. This section does not prescribe how soon after the event the exchange must prepare this summary statement, nor does it prescribe what information shall be made public. It has been stated by the authors of the bill that the intention is to give the broadest possible publicity in regard to short selling.

Obviously, the value of this publicity will depend upon how soon the information is given to the public. From our experience, it will be physically impossible to publish even the total short position in less than four or five days after the sales take place. If the names and addresses of the short sellers must also be included in the published information, the time required for the preparation of this information will be greatly extended. I can not undertake to estimate accurately how long it will take, but if the New York Stock Exchange had to publish in respect of each short sale the names and addresses of the buyer and seller, the names of their brokers and the name and amount of the stock, we would not complete the necessary work in less than two weeks and it might take as much as a month. This estimate may seem exaggerated, but there are more than 12,000 short accounts and, in addition, numerous daily in-and-out short transactions. I have not made an estimate of how many actual short transactions are made each day, but I know that compilation of our statistics requires the sorting and tabulation of approximately 50,000 tickets each day. The original reports made by brokers would have to be tabulated and verified as to name and amount, and, in order to be safe from libel suits, this work would have to be most carefully checked. The burden of labor which this bill would impose upon the New York Stock Exchange is fantastic. In addition, I assume that the exchange would be called upon to pay large sums for the publication of the information in accordance with the statute. The authors of this bill seem to believe this section is an innocuous one which will give information to the public. As a practical matter, it is prohibitive and in actual operation would prevent short selling.

Sections 5, 6, and 7 are obviously designed to make stock exchanges comply with the requirements of section 4. In brief, section 5 prevents any bank, and by definition that includes not only national banks, but also all members of the Federal reserve system, from advancing money or credit to an exchange or a member thereof unless the exchange is complying with the provisions of section 4. Section 6 prevents any bank or corporation engaged in interstate commerce from listing or permitting its securities to remain listed on any stock exchange which is not complying with the act. Section 7 prevents any stock exchange or member thereof, from transmitting through the mail or in interstate commerce any communication in regard to the short sale of securities, unless the exchange is complying with the provisions of the act.

Nobody, I believe, can read these sections without appreciating that the real purpose of the bill is to indirectly regulate stock exchanges. Mr. Perkins, who testified he had collaborated in the preparation of the bill, frankly admitted that Congress had no direct authority to legislate on this subject. Apparently, he has endeavored to accomplish by indirection the regulation of a subject which is not under the jurisdiction of Congress.

I am advised by counsel that the bill is unconstitutional. Aside from technical legal arguments, however, I ask the Committee to consider how this proposed bill seeks to sweep away all constitutional limitations on the power of Congress to regulate purely local and intrastate affairs. If Congress has the power to prevent the members of the Federal reserve system from advancing credit to any member of a stock exchange simply because it has not voluntarily submitted itself to a destructive regulation, then there is no limit to what conditions Congress may impose upon individuals seeking credit from members of the Federal reserve system. There is no form of human activity which could not conceivably be regulated in this manner. Congress might just as easily provide that unless I had my children educated in a particular manner, the credit facilities of banks belonging to the Federal reserve system should be denied me. I have been brought up to believe our Government was based on the theory that the Sovereign States should legislate in regard to purely local affairs and that the Federal Government should have jurisdiction of those general subjects set forth in the Constitution.

If any such indirect regulation as is contained in the proposed bill can be supported, the theory of our Government has been fundamentally changed and Congress may at any time destroy the sovereignty of the States.

Let me now pass to the section of the bill which vests in the Federal Trade Commission, the power, at any time or from time to time and for such period as in its judgment the circumstances may require, to suspend short selling and to prohibit any bank or corporation which permits its securities to be listed upon a stock exchange which is not complying with the provisions of the act from engaging in banking or interstate commerce. This section of the bill seems to avoid the whole issue. As I have already pointed out section 3 asserts that short selling is a vicious and unnecessary practice. If that is so, then it should be prohibited; if it is not so, then it should be permitted. There is no justification for Congress to

simply delegate to the Federal Trade Commission the power to determine whether short selling should be stopped or allowed.

I am aware, of course, that Congress has, in a number of instances, delegated to administrative bodies functions which seem almost legislative, but in each case, I believe, Congress has carefully defined the scope and duty of the administrative body. I know of no case in which an administrative body has been given the power to permit or prevent a usual business practice for no specific reason. The power of the Federal Trade Commission under this bill is unlimited. Whenever " in its judgment the circumstances may require " it may prevent short selling. It does not have to indicate what motives may inspire its action. It does not have to come to any finding of fact which may be reviewed by a court. It can act, if it sees fit, arbitrarily, but the action once taken is final. I can not help feeling that any such innovation in our system of Government is fraught with the greatest peril.

Before concluding, I would like to say a few words in regard to the history of the regulation of speculation, and particularly of efforts to regulate short sellling, I have had prepared a study of the various attempts which have been made in this country and in Europe to prevent by legislation alleged evils in the security market. I will not take the time of the committee to discuss these facts in detail, as I am aware that many members of the committee have already devoted much time and attention to this subject. I will, if you desire, Mr. Chairman, submit a study on this subject prepared by Mr. J. Edward Meeker, the economist of the New York Stock Exchange.

I can not, however, fail to mention here one or two of the most striking of these historical facts. The most recent, and probably the most elaborate attempt to regulate speculation in securities and particularly short selling, was the German experiment of the late nineties. The severe laws against speculation which were enacted in 1896 proved so detrimental to German business that within a relatively short period of time they had to be modified and were gradually repealed. By 1908 the last vestige of this attempt at legislative control of the security market had disappeared. There are innumerable studies of this legislation, but probably the most interesting are the first-hand reports of our own consuls in Germany, who, from an entirely unbiased point of view, studied the practical workings of this law. There were two reports made by the United States consul in Magdeburg, one in 1896 and the other in 1900. A more comprehensive report was prepared by our consul-general in the fall of 1900. These reports were all published by our Consular Service, and are, of course, available to the committee.

The failure of this attempt was complete. Speculation was not prevented as the authors of the law had hoped. German citizens who desired to speculate in securities still continued to do so, but their purchases and sales were made in foreign markets, such as Amsterdam and London.

The transference of the speculative market for securities outside of Germany had serious repercussions upon German financial life. Their own market for securities was so reduced in volume that it could easily be manipulated and it likewise failed to maintain a sufficient liquidity for the German securities which were held by

banks as collateral for loans. The net result was that the law created worse evils than those it was supposed to cure and ultimately the German Government was forced to repeal it.

The German experience is the most recent effort at complete regulation of the securities business. In the United States, however, we have had numerous State laws which attempted in one manner or another to prevent speculation and particularly, short selling. The State of New York enacted a law against short selling in 1812. The ineffectiveness of this statute ultimately led to its repeal and to-day short selling is not only legal in New York but the law specifically provides that no contract for the sale of securities shall be void or voidable because the vendor at the time of the making of the contract is not the owner or possessor of the securities sold. The State of New York has, as recently as 1909, carefully studied the whole question of speculation and short selling and there is no document which more forcefully points out the necessity of short selling than the report of the commission appointed by Chief Justice Hughes when he was governor of the State.

Congress, itself, has elaborately investigated the advisability of regulating the security market. The Pujo investigation and the hearings had upon the Owen bill went into all phases of the subject. As recently as the so-called " peace leak " investigation during the war, a committee of Congress carefully studied the effect of speculation and short selling upon the securities market. All these documents are available to the committee and I will, therefore, content myself with mentioning them.

While I am on the general subject of regulating, may I refer for a moment to the action taken in 1931 by the leading European exchanges. Some of the witnesses who appeared before the committee referred to the regulation of short selling by European exchanges and implied that the New York Stock Exchange had not been as active in restraining short sellers as the older exchanges abroad. I think the actual facts may prove of interest to the committee. As far as London is concerned, the stock exchange was closed on September 21, upon the announcement of the abandonment of the gold standard. On September 23, however, and due very largely to the fact that the Paris Bourse and the New York Stock Exchange had successfully weathered the crisis, the London Exchange was opened without any restriction upon trading whatsoever. By the 26th of September, however, the wild fluctuation of the British pound had created a curious situation in which English interest-bearing obligations were declining rapidly while British stocks were rising by substantial amounts. The officials of the London exchange thereupon ruled that contracts for the " term " or " fortnightly " settlement should cease and that all purchases and sales should be for cash.

Under their rules, however, a cash transaction is one in which delivery takes place on the next business day so that, in effect, the so-called cash transactions in London are absolutely identical with the regular manner of business on the New York Stock Exchange. This method of dealing was continued until November 16, when transactions for " fortnightly settlement " were again permitted, although a prohibition on option contracts and on the so-called " carry-

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ing over of term contracts" was still maintained. The last of these restrictions, however, was removed on January 26, 1932.

In Paris, the Government requested the bourse, which it actually controls, to take particular steps to prevent speculation for the decline. Aside from suppressing quotations and suspending dealings in particular issues which were directly affected by the abandonment of the gold basis by England, the bourse authorities contented themselves with the requirement that substantial margins be put up by short sellers. I have also been told that at a later period the bourse required its members to insist upon the actual delivery of at least a part of the amount of securities sold, but I am not informed as to how strictly this rule was enforced.

The Brussels Bourse was closed on September 21, but the cash market was reopened on September 22 and the term settlement market on September 23. Aside from the announcement that Belgian bankers had contributed to a fund for the purpose of supporting their own securities, no other unusual action was taken and certainly no prohibition or restriction on short selling was imposed.

The Berlin Bourse was closed at the time of the German moratorium in July. It reopened for a few days later in the fall and then closed again. It has not yet reopened.

Some reference was made to Italian and Japanese exchanges. I do not think that the experience of these markets is in any way applicable to the situation in America. As far as Italy is concerned, their security markets remained open throughout the entire period and no unusual restrictions were officially placed upon short selling. However, the security business, like all other forms of activity in Italy, is directly under the supervision of the Government and it is, therefore, impossible to determine what indirect forms of regulation may have existed. A witness before the committee implied that short selling was prohibited in Italy and was considered a major crime against the State. I can find no evidence that this is so. On the contrary, there are decrees of the Minister of Finance specifying the amount of margin required on long and short commitments which, by implication, suggest that short contracts are permitted.

As far as Japan is concerned, the abandonment of the gold standard on December 13 brought about such a violent rise in stock prices that the exchange was forced to close the next day. There is no indication that any restriction on short selling was ever imposed and it is perfectly clear that the closing of the exchange was brought about, not by short selling, but by a too rapid inflation of prices.

When you compare the steps taken by foreign exchanges with what the New York Stock Exchange has done, I think every fair-minded person will have to admit that, far from having been lax, we have, if anything, been more energetic than our foreign confréres. We have constantly watched the conduct of the market. We have required statistics which are infinitely more elaborate than any statistics available for any other market. Since September 21 we have had daily reports in regard to the short position, and these reports allow us to determine, not only the total position, but also the short interest in each individual stock. By requiring that every order be marked to disclose whether it is for long or short account, we have made it impossible for persons to raid the market. Our most recent action, requiring specific consent before customers' securities are

loaned, is only another method of preventing any possible abuse of short selling. In fact, we have taken every step to supervise short selling, but we are not willing to prohibit it because we feel that would be disastrous.

Mr. OLIVER. Did the President ask you to take that step?

Mr. WHITNEY. I do not feel that I can answer anything as to a conversation with the President without his express consent.

Mr. OLIVER. It was a great public matter, and you were acting publicly.

Mr. CELLER. I think the answer is sufficient. I think it is a rule of the President's office that such things may not be disclosed without his consent.

Mr. MICHENER. I probably spoke harshly a while ago. I apologize to my colleague from New York. In substance, this is what I intended to say: This is a judiciary committee dealing with a great subject. We never have had any politics in this committee. It has always been thoroughly understood that those things are to be dealt with elsewhere. I hope our new member of the committee will adhere to the common consent rule of the committee.

Mr. OLIVER. I never knew of any such rule, and do not know that I have violated it.

Mr. TARVER. I am in thorough accord with the rule. It seems to me to be material here whether this action was taken about the initiative of the New York Stock Exchange, because they believed it was an appropriate action to take to correct an existing evil, or whether it was taken without such belief, merely because of the request of the President of the United States. I think it is material for that reason.

Mr. MICHENER. I quite agree with the gentleman, if it is approached in that spirit.

Mr. OLIVER. I have not by any word of mine suggested that it was approached in any other spirit. I want to know whether this is the action of the New York Stock Exchange taken at the request or suggestion of the President of the United States, or whether it was an action of the New York Stock Exchange taken on its own initiative, predicated upon the necessities, as it saw them, of trading securities.

Mr. MICHENER. Again I was probably in error, but I coupled the last question with the question asked awhile ago.

Mr. OLIVER. I am afraid the gentleman's sense of humor is a little bit warped this morning. I hope he will sleep better to-night.

Mr. MICHENER. So do I. We do not want any humor here.

Mr. OLIVER. I am very sorry.

Mr. LAGUARDIA. I am quite interested in an answer to the question whether the action of the stock exchange was taken at the suggestion of the President of the United States.

Mr. WHITNEY. Do you want me to answer the question, Mr. Chairman? I have already stated I would prefer not to do so.

Mr. TUCKER. I do not think you have to answer that question.

Mr. CONDON. The question is pertinent, in my opinion.

Mr. MICHENER. I have no objection to the answer. If it is a good bill, the President is trying to accomplish the very thing Mr. LaGuardia is seeking.

Mr. LaGuardia. Yes; but certainly the question of whether the witness was governed by the sense of duty in the matter is pertinent, and it should be optional with him.

Mr. Tucker. I understand he has made that request.

Mr. Whitney. I did make that request. I am willing to answer the question if the President gives me leave to answer it.

Mr. Oliver. Suppose we hold it in abeyance until you may have an opportunity to see the President.

Mr. Whitney. That is entirely agreeable to me.

Mr. Oliver. If he declines to give that permission, let it appear on the record.

Mr. Michener. I am quite sure the President would favorably consider such a request.

Mr. Oliver. I make the request subject to that condition. I thought it was one of those things about which no objection could be raised, but I realize the situation you are in, Mr. Whitney.

Mr. LaGuardia. I take my work here rather seriously. I press the question without any consent from anyone.

Mr. Celler. The chairman has ruled that the gentleman need not answer.

Mr. LaGuardia. We have equal standing. If the gentleman desires to evade the question, or not answer it, that is his privilege; but let the record show it.

Mr. McKeown. Mr. Chairman, it seems to me we have put this witness in a rather embarassing situation. You have asked him if he did a certain thing because of a conversation with the President of the United States. He, no doubt, would not like to voluntarily give that kind of information, even if he had been asked if it did that at the suggestion of my good friend from New York, Mr. LaGuardia.

Mr. Oliver. I feel sure the President will have no objection. It was stated in the papers.

Mr. McKeown. He has not had the consent of the President to state what the President advised him to do, or whether he did advise him to do anything.

Mr. LaGuardia. I have heard of congressional immunity in the Constitution, but I never heard of any other.

Mr. McKeown. There is no immunity about it. It is just a question of courtesy, of common courtesy between gentlemen. I think it would be proper to ask him if this action was taken because he thought it ought to be done, rather than to ask him if it was done upon the suggestion of the President.

Mr. Oliver. I asked him if it was on the initiative of the President.

Mr. Tucker. Gentlemen of the committee, the witness says he prefers to adopt the suggestion made that he consult the President before answering this question.

Mr. Tarver. Let me ask this question.

Mr. Tucker. Are you a member of the subcommittee?

Mr. Tarver. Yes.

Mr. Tucker. Very well.

Mr. Tarver. Was the action taken by the board of governors of the New York Stock Exchange in reference to the matter under discussion in order to bring about the correction of existing evils, and if so, what existing evils were to be corrected?

Mr. Whitney. It was not taken in any way to correct any existing evils. I have stated here, I thought clearly, exactly why that action was taken.

Mr. Celler. Mr. Tarver was not in the room at the time.

Mr. Whitney. I beg your pardon. May I refer to this?

Mr. Tarver. That is not necessary

Mr. Whitney. This is what I said about it:

I mention this matter specifically because in the last few months misstatements in regard to the lending of margin stock have become more and more frequent. Last week the governing committee of the exchange, realizing that the popular misconception had grown so great as to disturb even many intelligent persons, decided to make its position in regard to the lending of stocks absolutely clear.

Mr. Tarver. That is the reason the exchange took the attitude it took?

Mr. Whitney. It is.

Mr. Tarver. It was not to make a bull market, make things look dressy when they were not?

Mr. Whitney. Sir, we never try to make a bull market. We are a market. Those outside of us make the market.

Mr. Tucker. I would like to get the sense of the committee. The question is whether the witness be permitted to consult the President before answering this question.

Mr. Tarver, what do you say?

Mr. Tarver. I feel that it is a matter to be left to the witness, I do not care to force him to answer the question, if he does not desire to.

Mr. Tucker. What do you say about the question?

Mr. Tarver. I think it is a proper question. If the witness declines to answer it, we have no power to compel him to do so.

Mr. Tucker. Mr. Oliver, what do you say?

Mr. Oliver. The way the Chair stated it, I do not think was the way the question arose—shall he be permitted to answer the question? The question was asked him, and he said he did not feel at liberty to answer the question until he had first consulted the President as to the propriety of answering it. Then the suggestion was made that we hold the matter in abeyance until he could see the President, and if the President refused to grant the consent Mr. Whitney thought he ought to have, let that fact appear upon the record. If I have recalled the situation correctly, I am disposed to agree with that procedure.

Mr. Tucker. Mr. McKeown, what do you say?

Mr. McKeown. Mr. Chairman, he is asked about a conversation with the President of the United States. He takes the position which I believe everyone of us would have to take if were asked such a question, if we were asked to disclose what transpired between ourselves and the President, without his consent. He simply asks the right to get that consent before he makes a statement of what transpired.

Mr. Tucker. What is your view, Mr. Michener?

Mr. Michener. My view is that the economics of the country to-day are in such a conditions that an ill-advised committee should

not for an instant insist upon the disclosure of any conference of the President of the United States with reference to economic conditions, especially when we are dealing with the head of the greatest stock exchange in all the world, and a word given out by this official might mean disaster to many securities of the country. I think we are imposing upon him. I think it is improper to even discuss a matter of that kind here, by a committee of jurists, so to speak. I am very much opposed to compel the gentleman to make an answer.

Mr. TUCKER. Mr. LaGuardia, what is your view?

Mr. LAGUARDIA. In the first place, Mr. Chairman, I wish to take an exception to the remark of my colleague that this committee is ill advised. In the second place, I can imagine nothing that is sacred about the New York Stock Exchange, or that this gentleman differs in any way from any other witness who comes before this committee. In the third place, permit me to say that the President has stated publicly that he conferred with officials of the stock exchange, and the President has also stated that he asked them to put this rule into effect. I have nothing more to say. I let the question stand, and let the witness reply in any way he desires.

Mr. TUCKER. Mr. Whitney, what is your position now?

Mr. WHITNEY. My position is exactly as it was, Mr. Chairman. I do not wish to appear in any way to evade any question by this committee. I will try to the best of my ability to answer them. On the other hand, out of courtesy to the Chief Executive of this Nation, I do not feel that I can answer a question which involves a personal conference with him without securing his release to do so. I wish to make it clear that I am not trying to evade in any way.

Mr. TUCKER. The Chair rules that you will be permitted to withhold your answer to the question until you see the President, but, upon seeing the President, that your answer may be returned to this committee.

Mr. WHITNEY. Mr. Chairman, then may I state the qeustion, which was, Did the President request this action, referring to the action of the governing committee of the stock exchange. That was the original question. There have been other questions. I have not the capability to remember them all. I would have to have them written out.

Mr. LAGUARDIA. I am sure we do not care to be technical about it. What we want to know, or what one member of the committee wants to know, is this: Did the President suggest it? Was it discussed with him, and after the discussion did that rule go into effect? Did the President ask you to do it?

Mr. MICHENER. He wants to know whether it was coercion or suggestion on the part of the President. If it was a suggestion, that is one thing; if it was coercion, it is something else.

Mr. TUCKER. Mr. Whitney, have you concluded your statement?

Mr. WHITNEY. No, sir; I have not.

Mr. TUCKER. You may proceed.

Mr. WHITNEY. Gentlemen, in conclusion, I wish to refer very briefly to what the New York Stock Exchange has accomplished in creating and maintaining standards for the security business. I trust you will not think me boastful in mentioning the constructive achievements of the exchange. I do so only because some people

seem to believe that the refusal of the exchange to prohibit short selling is based solely on the desire of its members to profit by the volume of business which short selling is supposed to produce. This, of course, is not true. The regulations which the exchange has voluntarily imposed on its members have, in practically all instances, diminished the volume of business which otherwise would have taken place upon the exchange. These regulations, however, have been adopted because we felt they were sound in principle. The exchange is and always has been willing to forego the personal advantage of its members for the accomplishment of constructive purposes. The listing requirements of the exchange are admittedly more severe than the requirements of any other security market in the world. In recent years these listing requirements have been expanded from time to time to meet new situations and to establish standards for new businesses which, in unregulated form, were proving a menace to investors. I refer particularly to the listing requirements for foreign shares which were adopted about five years ago; the requirements for management type investment trusts, which were adopted in 1929, and the regulation of fixed investment trusts which were brought about last year.

In addition, it has refused to list nonvoting common stock and has required the publication of complete and frequent financial statements. I need hardly tell you all of these regulations have met with bitter opposition. We have frequently been told that large companies which otherwise would have sought listing refused to do so until we modified our policies. Far from relaxing our standards in order to attract business, we have, if anything, raised them higher and higher, feeling sure that the protection of investors was worth infinitely more than the immediate profit of our members. As far as discipline is concerned, I doubt whether there is any institution in the United States which has established and maintained higher standards of business ethics. Finally, the supervision of the financial affairs of our members has year by year become more complete. It is not due to accident or chance that only a few members of the exchange have become insolvent during this drastic period of deflation. The record of the members of the exchange in this regard is outstanding. I mention all these matters not in a spirit of boastfulness but merely to rebut the idea that the stand which the exchange has taken in regard to short selling is affected by a desire for profits.

Gentlemen, let me refer to a statement that I made in my speech at Syracuse. I said there that "in so far as the exchange is concerned, the defense of short selling is not a matter of opinion, it is a matter of principle." All history indicates this practice is necessary for the maintenance of a security market. Our own experience which extends for more than a century and the experience of our sister markets in the capitals of Europe conclusively prove that no great security market can long endure if short selling is forbidden. Under these circumstances, we must oppose legislation which is intended to abolish or regulate short selling. We do not ask people to believe blindly our statements in this regard. All the facts and figures in the possession of the exchange are available to the committee and, after considering the evidence, I am confident you will

be convinced that a prohibition of short selling, either directly or through some form of regulation, will be disastrous.

Mr. TUCKER. Mr. Whitney, members of the committee will no doubt want to ask you a few questions. I should like to ask you one.

You mentioned in your statement that you or your counsel or both regard one of these bills as unconstitutional.

Mr. WHITNEY. Yes.

Mr. TUCKER. I want to suggest, if it be possible, that the committee would be very glad to have a brief from you or your counsel on that subject.

Mr. WHITNEY. Yes. You shall have it.

Mr. TUCKER. Merely on the constitutionality of it. Of course, that brief would be subject to be answered by any party desiring to do so.

You also suggested, I believe, that you would produce and put in your statement some matter that Mr. Meeker, I believe, the economist of the stock exchange, had written.

Mr. WHITNEY. I said I would send it to you, Mr. Chairman, for the committee. It is just in proof form and it is not yet available, but you will have it by the end of the week or the first of next week, if you desire it.

Mr. TUCKER. Gentlemen, I am going to ask the members of the subcommittee in turn if there are any questions they desire to ask Mr. Whitney.

Mr. CELLER. Will that preclude questions by those who are not members of the subcommittee?

Mr. TUCKER. Until after they get through.

Mr. McKeown, have you any questions to ask?

Mr. MCKEOWN. I have but one or two questions. I am frank to say that I do not know anything at all about stock speculation. I do not own any stock, and would not know it if I would see it. I want to know what is the difference, if any, in speculation, in long sales, and short sales. What is the element of speculation in that trading stock? That is what I am interested in.

Mr. WHITNEY. To my mind, sir, there is none, no distinction or difference at all. One seeks a profit on the enhancement of the price if he buys, and one seeks a profit on the decline in the price, if he sells. Both are margined. Both seek a form of credit. The purchaser long goes short of money; and the seller short goes short of stock and long of money.

Mr. MCKEOWN. The thing I have never been able to understand, just as an illustration, is a situatiion where a corporation has 300,000 shares of stock, and in transactions on the exchange many shares are sold in excess of the number actually in existence. Is there any way in which that is an evil, and if so, is there any way to stop it?

Mr. WHITNEY. If you grant the necessity of market, then I contend, and hope you agree, that such speculation is an integral part of all markets in existence. Then as to the frequency with which the capital stock of a company is turned over is just a phase of that market. There is no rule in the world to prevent a man, whether he be on the exchange or in Oshkosh or in China or wherever he may be, from buying and selling the same stock fifty times during the same day.

Mr. MCKEOWN. To put my question in concrete form, I know more about hogs than I do about stock. Suppose I have 500 head of hogs, and I have business transaction with those hogs. They are the only 500 hogs I can sell or buy or trade. I can either trade 500 hogs for 500 other hogs or a less number. I can understand that, but I can not understand how you can have a corporation with 500,000 shares, and transactions taking place by which they can sell 1,500,000 shares.

Mr. WHITNEY. I understand the reference entirely as to hogs. Unfortunately, all of mine just died of cholera. I can see the situation you have in mind, sir, with reference to your 500 hogs. You may sell them to an individual. That individual may sell them to another individual. That individual may sell them to another, and so on. You may later conclude that you made a mistake in the price at which you sold the hogs and you may buy them back from the fourth individual and in turn sell them to a fifth. That could happen. I am not meaning in any way to be facetious. It is the same with cattle or hogs or grain or securities. That is what does happen. There is a tremendous turnover in the shares of corporations on the exchange on a specific day.

Mr. MCKEOWN. Suppose I take my 500 hogs to the market at Oklahoma City and sell them there. The fellow who buys them from me may sell those hogs to another man, and the next fellow may buy from him. Is there any way on the exchange where some other man can sell my 500 hogs at the same time I sell them?

Mr. WHITNEY. Only if you loan them to him, or if the person to whom you have sold them will loan them to him, against delivery that he must make. On a futures market—I do not know whether that situation prevails in the hog or cattle market—the delivery has to be made the next day. It is a rule of the stock exchange that an actual physical delivery of the certificate must be made.

Mr. MCKEOWN. What I can not understand is, when they sell 1,000 shares of stock, and there are only 500 actually in existence, how do they settle that up? How do they settle up next day, if they have only 500 shares?

Mr. WHITNEY. That is settled by what is called the stock-clearing corporation, which is exactly the same as the clearing corporation for checks drawn on banks. A man may present a bill, and the receiver of that money when paid may draw checks to pay other bills, but when you come to the clearing house, they are all balanced and settled for.

Mr. MCKEOWN. I can not quite see how they can have but 500 shares, and still dispose of a much greater number.

Mr. WHITNEY. Every man who sells 500 shares must deliver it.

Mr. MCKEOWN. How does he sell 500 shares? Here is one man selling 500 shares, and another man selling 500 shares. How is that man going to deliver his 500 shares, and this man going to deliver his 500 shares, when there are only 500 shares out?

Mr. WHITNEY. I will grant that may be speculative, but any individual engaging in such a transaction must be able to borrow the shares for delivery next day.

Mr. MCKEOWN. This man over here would not have very much chance to borrow them.

Mr. WHITNEY. Then he is out of luck.

Mr. LaGuardia. What happens then?

Mr. Whitney. He has to get them. If he does not, the man with 500 hogs or 500 shares can hold out for such price as he deems reasonable.

Mr. McKeown. It seems to me there should be some way to make a more stabilized market. That is the impression I have. I do not know of any way to express it in my business, to express it from a common-sense viewpoint. I think there is something there that should be eliminated, and that the elimination of that something would stabilize the market. It confuses me. I do not know just what it is. According to your statement, if you should eliminate short selling entirely, you would eliminate the market, and the exchange is nothing more than a market.

Mr. Whitney. That is all.

Mr. McKeown. If I have shares of stock, even though I may have to take a loss, it may be a great accommodation to me to get rid of them immediately. I may want to do that. There ought to be some way to have a more stabilized market and eliminate too much speculation. A fellow would not last long in the hog business if he tried that kind of speculation.

Mr. Whitney. May I say to you, sir, before you go, the instance that you cite with relation to the total turnover of the capital issue in one day or in a very short period, is not a very prevalent situation on any market, but the very tremendous turnover in these stocks makes for that very stabilization or equilibrium of market, giving thereby to anybody who wants to buy and sell a chance to buy and sell at a price within close fluctuation. I see what you have in mind. It might in some way be affected. I do not know how. Nevertheless, that is the very essence of the matter.

Mr. McKeown. I was thinking of a situation where some corporation had stock it was very much interested in maintaining at a certain price, vitally interested in the stability of that price and that situation might be seriously disturbed by interlopers trading in that stock on the otuside. Is there any evil arising from that standpoint?

Mr. Whitney. My answer is emphatically no. As a broker, whenever I have been given orders which are called " peg orders " to prevent a stock going below a certain price, I tell them that is the most ridiculous thing in the world. A " peg " price, whether to short or long selling, always gives the impression there is something artificial in the situation. A normal reaching of a price level is what we are interested in.

Mr. McKeown. The thing is more profitable to all concerned if the market is stabilized, without violent fluctuations up and down.

Mr. Whitney. Absolutely.

Mr. McKeown. I am just talking frankly to you, sir. To my mind, there is something within that transaction. I am inclined to think it is not in the short selling, but somewhere in there is something that can be eliminated and get rid of that speculation.

Mr. Tucker. The committee will adjourn until half past one.

(Whereupon, at 12 o'clock noon, the committee adjourned for the noon recess, to meet again at 1.30 o'clock p. m.)

AFTER RECESS

The subcommittee reconvened, pursuant to recess, at 1.30 o'clock p. m., Hon. Henry St. George Tucker presiding.

STATEMENT OF RICHARD WHITNEY, PRESIDENT NEW YORK STOCK EXCHANGE—Continued

Mr. Tucker. The subcommittee will be in order. Mr. Whitney, will you resume your statement?

Mr. Condon. Mr. Whitney, I would like to ask you what is the likely effect, in your opinion, upon short selling of the recently published ruling of the exchange?

Mr. Whitney. In all honesty, I can only express an opinion and it is only an opinion. I do not believe in the last analysis that it will prevent stocks being available for loaning purposes.

Mr. Condon. You do know that there is an opinion in the Street that that is going to be the ultimate effect of your ruling, that there will be a shortage of stocks for loaning purposes?

Mr. Whitney. Do I think that is the opinion in the Street?

Mr. Condon. Have you heard any such opinion being expressed?

Mr. Whitney. I think there have been divergent opinions.

Mr. Condon. What abuse, if it was an abuse, did you seek to correct by this ruling?

Mr. Whitney. We didn't seek to correct any abuse. We merely tried to clarify what had appeared to be a misunderstanding in the minds of a great many people. The so-called customer's agreement that each brokerage house asks of a customer when opening an account included permission from the customer to the brokerage house to lend his or her stocks. That is in all customers' agreements I know of that have existed. Because of the misunderstanding as to the giving of that permission—having been made—and as to the possibility of revocation, which existed always, we felt it would be a proper thing to bring that pointedly to the minds and knowledge of all customers so that they could see very clearly, without question, their rights, although they previously had them.

Mr. Condon. No one complained about this lack of knowledge on the part of customers as to the right to prevent their stocks from being loaned, did they, to the board of governors? No one has complained?

Mr. Whitney. I will not say that they specifically did or did not complain. If they raised the question it was always pointed out to them that was their right and privilege.

Mr. Condon. Let me put a question in a different way. Was there any complaint made to the board of governors about this particular matter, which prompted you to hand down the ruling you did?

Mr. Whitney. Yes; that has come from customers and from houses and from various sources.

Mr. Condon. Did those complaints increase in volume within recent months or are they something that have been coming to you regularly or intermittently over a long period of time?

Mr. Whitney. Both.

Mr. Condon. But you did not feel it necessary to do what you have just recently done until this present month?

Mr. WHITNEY. Until the complaints grew in volume—right, because if I may say, the right always existed with the customer prior to the putting of this rule into effect.

Mr. CONDON. It did always exist with the customer?

Mr. WHITNEY. Always.

Mr. CONDON. And you do not believe that any substantial improvement has been made in the whole mechanics of short selling as a result of this ruling, do you?

Mr. WHITNEY. Except in so far as it makes perfectly clear to the customers what their rights are.

Mr. CONDON. What effect do you think this ruling will have upon the volume of short interest in the market from now on?

Mr. WHITNEY. I think answered that question when you first asked me.

Mr. CONDON. I believe you did, but I would like to get it in answer to this question so that it will appear in direct answer to this question in the record.

Mr. WHITNEY. As I said, it is purely my personal opinion that it will not affect materially the availability of stock for loaning.

Mr. CONDON. So that the short selling will be just as easy from now on as it has been in recent months before your ruling?

Mr. WHITNEY. So that stocks available to be borrowed against short sales will be there; yes. Whether if sold short or not, whether the quantity is larger or smaller depends upon the desires of the short sellers.

Mr. CONDON. And, of course, if the stock was not available for loaning purposes, it would have a tendency to reduce the volume of short selling, would it not?

Mr. WHITNEY. To curtail short selling?

Mr. CONDON. Certainly. Now, there is one question here that I would like to ask you for your own opinion. Is it your opinion that short selling has served a good purpose during this depression, that is, since the stock market broke in October, 1929?

Mr. WHITNEY. Absolutely.

Mr. CONDON. And as it has been practiced prior to this ruling that just went into effect?

Mr. WHITNEY. Yes.

Mr. CONDON. Then you do not agree with what has been said by prominent officials, without naming them, that the short selling has interfered with the return of prosperity or has been an important factor in interfering with the return of prosperity, short selling on the exchange?

Mr. WHITNEY. That is a fairly large question. I think I have covered it in the brief I have read. I believe that short selling was a necessity, and that short selling has not been the cause of declining prices.

Mr. CONDON. Do you think you have answered it fully in your statement?

Mr. WHITNEY. I think so.

Mr. CONDON. I thought I followed you closely but I did not think you had such an answer as would be a complete answer to that question.

Mr. WHITNEY. I tried to point out the various situations by chronological order that I thought had a vast influence on declining prices and brought prices down. I tried to show in that connection that at times, while prices were declining, the short interest was also declining and that, therefore, it was not the cause of declining prices.

Mr. CONDON. Just in that connection, referring to these charts which you have given out to us, I do not claim to be well informed on how these charts should be read, but looking at that dark line, the full black line, it represents the total number of shares composing the short interest.

Mr. WHITNEY. On which of the three pages?

Mr. CONDON. It is headed 1931.

Mr. WHITNEY. 1931?

Mr. CONDON. And comparing it with the broken lines, looking at it where the middle line shows June 17, as the average of the price went up on those 90 stocks, does not that line show that the volume of the short interest declined?

Mr. WHITNEY. Yes.

Mr. CONDON. Is not that contracy to your statement that the volume of the short interest tended to go along with the rise in price, that there wasn't any difference?

Mr. WHITNEY. No, sir. I specifically stated that situation in the price index from June 17 until July 3, and also the curve or the line of total short interest.

Mr. CONDON. I want to get it clear for my own mind. According to these charts as I understand them, from June 17 until some time in July, there was a rise in the price index of these 90 stocks?

Mr. WHITNEY. That is correct.

Mr. CONDON. And at the same time there was a very pronounced decline in the total number of share composing the short interest?

Mr. WHITNEY. There was a considerable decline; yes.

Mr. CONDON. Looking at the next chart in the order in which you have given them to us, does not the same set of facts continue in that chart, too, that wherever there was a rise in price there was a corresponding decline in the volume of the short interest, the number of shares composing the short interest?

Mr. WHITNEY. At periods; yes. But the contrary, the reverse is also true, and that was on what I based my statement that these charts do not show that the increase in the short position pushed prices down necessarily. They work both ways.

Mr. CONDON. How can you tell that from the charts?

Mr. WHITNEY. Because, going back to an instance you have called my attention to, from June 17 until the middle of July, or to July 3, let us say, prices went up and the short interest declined. That does not signify you might take from that the inference that because of the decline in the short interest that caused prices to rise. I am not claiming any such thing for it. I am merely claiming that the short interest did not force prices down. Your particular question, I think, tends to back me in that attitude.

Mr. CONDON. I have no preconceived notion about this thing.

Mr. WHITNEY. I do not give a great deal of strength to charts.

Mr. CONDON. I am glad you said that so that it will go in the record. The charts do not always tell the true story, do they, with respect to price movements?

Mr. WHITNEY. No; but why I brought this up is that the charts had been used to prove that the short interest had caused declining

prices and I tried to point out by referring to the charts in refutation, that that was not a fact.

Mr. CONDON. And it has also been said, getting back to the question I asked you a moment ago, it has also been said by those in high places that prosperity has been retarded by short selling on stock exchanges. Is not that true? You know that to be so, do you not?

Mr. WHITNEY. I believe that general statement has been made with ramifications to it.

Mr. CONDON. You disagree with it?

Mr. WHITNEY. I do not feel that short selling has caused depression or declining prices or has been a major cause in that respect.

Mr. CONDON. One more question and I am finished. Has it aggravated it?

Mr. WHITNEY. Per se I would say it has not. Because, perhaps, of the public mind that pays so much attention to what shares are selling at, it may have created a false impression, but that impression does not upset the principle involved as to short selling being economically a necessary function.

Mr. CONDON. Then at a time of public uneasiness such as the present, would you say that there ought to be a more stringent regulation by your exchange of the operators on the short side of the market?

Mr. WHITNEY. Beyond what we have done; no.

Mr. MICHENER. Then it is your judgment that short selling as indulged in on the New York Stock Exchange is not injurious to the stock market?

Mr. WHITNEY. That is my judgment.

Mr. MICHENER. Therefore, in your judgment it would naturally follow that no legislation is necessary in connection with short selling, neither are any regulations on the part of the board of governors required. Is that correct?

Mr. WHITNEY. That is correct.

Mr. MICHENER. We were told by Mr. Elkhorn, I think his name was, a witness, that these practices were most injurious, in fact, inimicable to the good of the public and the stock market. He advised the committee that in his judgment it would be very unsafe to take hasty action, and that in his judgment this committee did not have sufficient data upon which to base legislation, but he concluded that these evils might be overcome by the stock exchange itself within 24 hours if the stock exchange were to act. You do not agree with that conclusion at all?

Mr. WHITNEY. Mr. Congressman, that again is a very broad question.

Mr. MICHENER. I appreciate it.

Mr. WHITNEY. I have stated here, and I reiterate that the stock exchange or the governors of the stock exchange, are at all times watching the market and what is involved in the market, the conduct of its members in every way. I do not get from what you just said or from what you referred to as the gentleman's statement what specific evils existed. We are always willing to have advice as to evils, concrete evils. I do not say that the stock exchange may not from time to time, as they always have in the past, pass a rule for this or that regulation, but in so far as we now see the situation, particularly regarding short selling, we do not believe regulation should be enacted.

Mr. MICHENER. Then the necessary deduction from your statement is that short selling may be practiced in such a way as to be inimicable to the public good as far as the stock exchange is concerned, and that you control that hazard by watchfulness of the members. Is that correct?

Mr. WHITNEY. Legitimate short selling is absolutely necessary and proper. What is sometimes called illegitimate short selling we understand as bear raiding, and against bear raiding we have always stood as firmly and as strongly as we possibly can. We do not allow it and we do not believe that it exists.

Mr. MICHENER. I based my question on your statement that your board of governors, whoever is in control, are constantly on the alert and watching out, keeping a lookout, let us say, for these short-sales transactions.

Now, it occurred to me that if short selling could be indulged to such an extent that it would be injurious to the market, then there might be a point where legislation might come in and prevent the very thing which you say is being prevented because of that watchfulness. In other words, we appreciate human fallibility in that you may not be watching all the time, and if that were true, then there might be a place for legislation to take effect, particularly, beyond which you may not go? How about that?

Mr. WHITNEY. I do not agree.

Mr. MICHENER. I did not expect you would.

Mr. WHITNEY. I do not think legislation would ever be able in any way to establish the manner of and control the activities of the stock exchange as do the governors of the exchange. I do not grant there are evils in short selling as it now exists. The evils or abuses that may come through bear raiding are prevented. It does not exist, and I believe short selling is essential for the market and that the market is essential for the country.

Mr. MICHENER. I do not think there is any dispute from the various witnesses up to date on your last proposition. Every one has agreed that short selling has its place in the picture, but that there were times when short selling was indulged in to such an extent as to become a menace to the market, and those who favor regulation seem to feel that something should be done. That is all.

Mr. LAGUARDIA. Could not Mr. Whitney sit down?

Mr. WHITNEY. I am very happy to stand.

Mr. LAGUARDIA. Mr. Chairman, just before recess there was some question as to whether or not the question submitted was improper; that is, if it was rather not in keeping with custom to ask the witness with reference to the President. I sent to the White House to the press room, after checking up the statement that was contained in the daily press of February 20—I sent to the White House press room to get the statement which went out, and this is the statement:

FEBRUARY 19, 1932.

The President said:

"I have a question from the press as to conferences held with officials of the New York Stock Exchange. There have been discusssions, as is reported, between myself and other officials of the administration with officials of the New York Stock Exchange on the question of bear raids. Stock exchange officials have, during the past eight months, from time to time taken steps to restrain bear raiding with a degree of success, but during the latter part of January, despite these steps, there was a large increase in the short account which un-

questionably affected the price of securities and brought discouragement to the country as a whole. I, and other administration officials, again expressed our views to the managers of the exchange that they should take adequate measures to protect investors from artificial depression of the price of securities for speculative profit. Individuals who use the facilities of the exchange for such purposes are not contributing to recovery of the United States."

That is the President's statement as given to the press.

Mr. Whitney, besides being president of the Stock Exchange, you are also a broker actually engaged in the business?

Mr. WHITNEY. Yes.

Mr. LAGUARDIA. What is the name of your firm?

Mr. WHITNEY. Richard Whitney & Co.

Mr. LAGUARDIA. Is George Whitney your partner?

Mr. WHITNEY. He is not.

Mr. LAGUARDIA. You stated that short sellers come to the rescue of the market. Did I understand you correctly on that?

Mr. WHITNEY. I said the short sellers were potential and necessary purchasers of stock to complete their contracts, and in falling markets they serve as the "cushioning influence"—sometimes so expressed by economists.

Mr. LAGUARDIA. But the very primary and sole purpose of selling short is to sell in a declining market?

Mr. WHITNEY. No.

Mr. LAGUARDIA. That is not the primary purpose of the short seller?

Mr. WHITNEY. In a declining market?

Mr. LAGUARDIA. Yes.

Mr. WHITNEY. Their primary purpose in selling is to purchase back at a lower price, but it is not a fact that short sellers only sell in a declining market by any manner of means.

Mr. LAGUARDIA. Then the sole purpose of the short seller is to repurchase at a lower price?

Mr. WHITNEY. Exactly as the margin purchaser desires to resell at a higher price. Mr. Congressman, may I say this for the information of the committee. Short sellers are not always successful, and it is a time-honored adage, "No short seller has ever died rich." We are in, or have been in, a time of a declining market, but short sellers have operated in all markets, bull markets and in bear markets.

Mr. LAGUARDIA. Since 1929 we have not seen any of these short sellers on the bread line, have we?

Mr. WHITNEY. That is something I can not tell you. We have had very substantial rallies in the market since 1929.

Mr. LAGUARDIA. Then, of course, you would qualify your statement that short selling serves as a cushion. That is only incidental to the real purpose of the short seller, is it not?

Mr. WHITNEY. Yes.

Mr. LAGUARDIA. But that is not what he has in mind.

Mr. WHITNEY. Of course, he has in mind that he has to buy his stock back. That is self-evident.

Mr. LAGUARDIA. But he certainly does not go into the market for the purpose of buying it back at a higher price?

Mr. WHITNEY. At times.

Mr. LAGUARDIA. The seller goes into the market for the purpose of buying it back at a higher price?

Mr. WHITNEY. Are you talking about when he originally sold?

Mr. LAGUARDIA. Certainly.

Mr. WHITNEY. No; but he goes into the market many times after he has made his first commitment and buys it back at a higher price.

Mr. LAGUARDIA. Do you think that the market value of that stock on a given day is influenced by the number of shares of stock offered for sale on that day?

Mr. WHITNEY. It may. It depends on the trend of the market.

Mr. LAGUARDIA. Do you think that the greater the number of shares so offered, the greater will be the influence of the offering on the market price that day?

Mr. WHITNEY. I am not trying to evade, Mr. Congressman, but naturally, if there is a preponderance of sellers over the buyers, or vice versa, so will the market react to that fact. Is that an answer?

Mr. LAGUARDIA. I will take your answer.

Mr. WHITNEY. I am trying to give you as frank and truthful an answer as I can.

Mr. LAGUARDIA. Do you think, therefore, that the addition on any particular day of the shares sold short influences the market price of securities that day?

Mr. WHITNEY. Not any more than the influence of additional purchases on margin would influence the market. The two balance each other in the market.

Mr. LAGUARDIA. You believe I ought to add margin sales to H. R. 4 to make it complete?

Mr. WHITNEY. Certainly if you wish to prohibit short selling.

Mr. LAGUARDIA. Would you indorse my bill then?

Mr. WHITNEY. No, sir. Then you are doing away with what is essential to a market.

Mr. LAGUARDIA. If a short sale will check a rising market because it increases the selling supply, will it not for the same reason depress a declining market?

Mr. WHITNEY. I have never said that short selling necessarily will prevent a rising market, in fact, I have always contended that short selling and purchasing on margin merely give stabilization or equilibrium to a market, and to put it in the words some one else has expressed—this very wise thought—that those two parts constituting speculation in a market, "smooth the waves but never affect the tides," the tides being the trends which are dependent upon general conditions, and those two parts of the market make for equilibrium and stabilization while those trends are in action.

Mr. LAGUARDIA. You made reference this morning to a quotation from an anonymous article, I think it was in the Financial World, Mr. Perkins referred to, about the words south of Fulton Street—do you know the author of that article?

Mr. WHITNEY. I do not.

Mr. LAGUARDIA. Do you know he is a former member of the stock exchange?

Mr. WHITNEY. I do not except in so far as it was stated in evidence here.

Mr. LAGUARDIA. Do you know Mr. Gunther, the editor?

Mr. WHITNEY. I do not know him. I know he is editor of the Financial World.

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Mr. LaGUARDIA. Do you think that short selling in 1931 had no influence through increase of selling supply on the liquidation and the decline in security values that occurred that year?

Mr. WHITNEY. It may have had influence but I do not think it forced the decline of prices.

Mr. LaGUARDIA. Would a short sale be made unless the short seller expected to make a profit through that transaction?

Mr. WHITNEY. No more than a margin purchaser buys except with the intention to make a profit by that transaction.

Mr. LaGUARDIA. You referred this morning to investment and speculation.

Mr. WHITNEY. Yes.

Mr. LaGUARDIA. The speculator depends on the fluctuations in the market either one way or the other, does he not?

Mr. WHITNEY. To make a profit or to make a loss?

Mr. LaGUARDIA. To make a profit.

Mr. WHITNEY. Or a loss.

Mr. LaGUARDIA. Or a loss.

Mr. WHITNEY. Yes.

Mr. LaGUARDIA. It is fluctuation, and the more fluctuation in the market the more the speculators?

Mr. WHITNEY. That is possible.

Mr. LaGUARDIA. And the more the speculators and the more the fluctuation the more business the brokers of the stock exchange have?

Mr. WHITNEY. That is possible.

Mr. LaGUARDIA. The commission on a speculative sale or purchase is the same as on an investment sale or purchase.

Mr. WHITNEY. Where the commission is paid. In other words, I merely make the difference there between a nonmember and a member.

Mr. LaGUARDIA. We are talking about members now. The commission is the same.

Mr. WHITNEY. If we are talking about members, there is very little or no commission paid. If you are talking about nonmembers trading through members, then my answer is yes.

Mr. LaGUARDIA. What is the source of income of the members of the stock exchange if it is not commissions?

Mr. WHITNEY. I said there are two, one who trades for himself and one who trades or executes orders of nonmembers.

Mr. LaGUARDIA. I am assuming he is executing an order.

Mr. WHITNEY. An order for a nonmember?

Mr. LaGUARDIA. Yes.

Mr. WHITNEY. My answer is yes.

Mr. LaGUARDIA. That his income is derived from commissions.

Mr. WHITNEY. That is part of it. I want to make that pointed. That is part of it.

Mr. LaGUARDIA. What other?

Mr. WHITNEY. What kind of business?

Mr. LaGUARDIA. What other business?

Mr. WHITNEY. That trade. There are brokers that deal only for cash. There are brokers the large part of whose business is done not entirely on the stock exchange, but off the exchange and over the counter. There are many ramifications to the brokerage business

even though the individual firm or person may be a member of the stock exchange.

Mr. LaGUARDIA. Of course, the purpose of this inquiry is limited to members of the stock exchange.

Mr. WHITNEY. So I understand.

Mr. SUMNERS. Will you develop whether there are any other profits derived from memberships on the stock exchange other than on commissions?

Mr. WHITNEY. Yes. A broker may trade for his own account, taking a position long or short for his own account in stocks listed on the exchange, and as against that trading for speculation that Mr. LaGuardia spoke about, the business for cash, buying and selling securities on the exchange for cash, a very material part.

Mr. SUMNERS. What is the percentage in your judgment relative to transactions where brokers act as intermediaries and collect commissions and transactions where brokers act upon their own account and are merely merchants in stocks and bonds for themselves?

Mr. WHITNEY. I am afraid I honestly could not answer your question. The ramifications of the business are so great that I could not answer the question. I may be able to answer it more specifically in another way. My counsel here says in answer to that part of your question that 30 per cent of the business done on the exchange is done by the odd-lot dealer. The odd-lot dealer deals directly with the customer who buys or sells in less than 100 shares. On the other, I do not think we have any statistics, and I would not dare to give an opinion or a guess.

Mr. LaGUARDIA. Did I understand you to say in reply to my last question that in addition to acting as a broker for a nonmember, a member of the stock exchange may also speculate or invest for his own account?

Mr. WHITNEY. Yes.

Mr. LaGUARDIA. So that it is possible for a broker to trade on the stock exchange, a member of the stock exchange, to be in the market short and at the same time placing orders for his customers on margin?

Mr. WHITNEY. Yes.

Mr. LaGUARDIA. Does not the opportunity for such a profit to the short seller lie solely in a subsequent possible decline in the market value of the shares he has sold short?

Mr. WHITNEY. Certainly.

Mr. LaGUARDIA. That is self-evident?

Mr. WHITNEY. Certainly.

Mr. LaGUARDIA. Does not this situation make the short seller desire to repurchase the shares he has sold short at a time and in a manner that will restore any market decline as little as possible in order that his profit may be as large as possible?

Mr. WHITNEY. Yes; I think that the answer is yes, that that is when he wants to repurchase. That is not when he necessarily does.

Mr. LaGUARDIA. Does not such desire and opportunity tempt the short seller into ways and means of bringing about the desired decline in market value in order that he may make his desired profit, such as gloomy predictions and circulation of various rumors?

Mr. WHITNEY. Again, on the conjecture, yes; but, on the other hand, that has nothing to do, as I see it, with the function of the short sale.

Mr. LAGUARDIA. But it is a practice that has been created.

Mr. WHITNEY. I do not grant that.

Mr. LAGUARDIA. But it is a practice that is exercised by the short seller.

Mr. WHITNEY. I do not grant that. That is something we absolutely prevent and fight against in any instance that may be brought to our attention and investigate, and we have not found that to be true, as I said this morning.

Mr. LAGUARDIA. What is a market rat?

Mr. WHITNEY. I do not know.

Mr. LAGUARDIA. I got this from a broker. Did you ever hear of groups of men in and around the stock market that go from place to place and whisper and circulate false rumors?

Mr. WHITNEY. No, sir.

Mr. LAGUARDIA. You have never heard of it?

Mr. WHITNEY. I have heard that such a thing has been stated to exist, but no investigations of ours have ever proved it so.

Mr. LAGUARDIA. Have you investigated that condition?

Mr. WHITNEY. We have investigated where it has been signified to us that groups were concentrating on the market on the bear side. Our investigations have never proved that to be a fact.

Mr. LAGUARDIA. But it has been called to your attention?

Mr. WHITNEY. Yes.

Mr. LAGUARDIA. Now, this morning you stated that since 1929 the exchange has been very careful in checking up on bear raids.

Mr. WHITNEY. Yes.

Mr. LAGUARDIA. And that if you discovered any such practice you would immediately penalize it.

Mr. WHITNEY. Yes.

Mr. LAGUARDIA. Since 1929, how many of your members have been penalized for bear raids?

Mr. WHITNEY. Members?

Mr. LAGUARDIA. Yes.

Mr. WHITNEY. None. In line with my statement this morning that we had not found evidence of bear raiding on the part of our members or on the part of any within our control.

Mr. LAGUARDIA. Would it be possible to have bear raiding and a broker member of the exchange know nothing about it?

Mr. WHITNEY. I think so. It might be possible.

Mr. LAGUARDIA. But, of course, if we had publicity, such as provided in H. R. 4, that would be notice that there was bear raiding going on, would it not?

Mr. WHITNEY. No, sir.

Mr. LAGUARDIA. Not in your opinion.

Mr. WHITNEY. Certainly not, in my opinion.

Mr. LAGUARDIA. But you say it would almost make short selling prohibitive?

Mr. WHITNEY. I say yes, because of certain other elements.

Mr. LAGUARDIA. H. R. 4.

Mr. WHITNEY. Not because it would prevent bear raiding, but because it would prevent short selling.

Mr. LAGUARDIA. I want to thank you, Mr. Whitney.

Mr. WHITNEY. I have stated that.

Mr. LAGUARDIA. Did not the exchange adopt a rule last year forbidding short sales to be made at less than the previous long sale, just to prevent one form of bringing lower prices through short sales, namely, offering short sales at successively lower prices?

Mr. WHITNEY. It did not.

Mr. LAGUARDIA. Do you think that a short seller confines his expectation of a profit from a decline in the market value of the shares he has sold entirely to his forecast of the business of the company whose stock he has sold, and that the short seller does not rely in any part on the extent of the short selling bringing a decline in price of that stock?

Mr. WHITNEY. I am sorry, but I have to ask you to read that to me again.

Mr. CELLER. Withdraw it. I did not understand it myself.

Mr. LAGUARDIA. I did not think you would. It means this, in language that my colleague can understand.

Mr. CELLER. I understand what you are driving at, but ask it in your own language instead of some one else's language.

Mr. LAGUARDIA. Don't you worry about that.

Mr. WHITNEY. As I see it there are two questions in two parts. The answer to the first part is that a short seller does rely upon his own forecast of the business of the company or on general business conditions or upon information that may have been given to him with respect to the one or the other.

Mr. LAGUARDIA. Or does he depend upon short selling bringing that down?

Mr. WHITNEY. No.

Mr. LAGUARDIA. He relies on his own information?

Mr. WHITNEY. I think so, absolutely on his own information except on what I said besides.

Mr. LAGUARDIA. General miscellaneous conditions?

Mr. WHITNEY. General business conditions; world conditions. I do not want to stress this point too often, but the short seller in his desire is just the opposite, just the reverse of the purchaser on margin.

Mr. LAGUARDIA. Of course. If he can get more people to sell short he has a reasonable expectation that it will depress the market.

Mr. WHITNEY. Only if he is right in his conjecture as to the trend of the market.

Mr. LAGUARDIA. You know that companies in good condition have had their securities pulled down without any change in their financial condition or their commercial or their moral standing in any way. Is not that true?

Mr. WHITNEY. It was stated here as evidence the other day in the way of a surprise that shares of a company had sold from 180 down to 30 and that the current assets of the company covered the total outstanding capital stock at the price of 30. Therefore, why should anybody want to sell that stock or what justice had it in selling at that price? I know of many such situations. But the point is that people owning that stock for one reason or another want to sell it to receive money, and there are not sufficient buyers, even knowing that the current assets of that company are sufficient to

retire that stock at that price, who are willing to go in and buy it. There must be a buyer for every seller and there always is at a price.

Mr. LaGuardia. Are you familiar with the stock known as United Corporations?

Mr. Whitney. Yes.

Mr. LaGuardia. The United Corporations was a holding company, was it not?

Mr. Whitney. It is.

Mr. LaGuardia. It is one of the J. P. Morgan companies. Am I right?

Mr. Whitney. Some of that firm are directors in the company.

Mr. LaGuardia. Your brother is a director in that company, is he not?

Mr. Whitney. Yes. My firm is a specialist in that stock, too.

Mr. LaGuardia. At the high point in 1929, the securities of the United Corporation sold for $1,397,000,000. Is that figure correct?

Mr. Whitney. I have no idea. It sold up in the 70's at one time. I have never reckoned it. The shares sold in the 70's at one time.

Mr. Celler. What is the par of it?

Mr. Whitney. I do not think there is any par.

Mr. LaGuardia. Do you know if there was any bear raiding on that stock?

Mr. Whitney. I do not.

Mr. LaGuardia. It has shrunk in value since then.

Mr. Whitney. Any holding company would, Mr. Congressman.

Mr. LaGuardia. The figures which I have would indicate that it shrunk $1,170,000,000, from $1,397,000,000.

Mr. Whitney. Over one billion shrinkage?

Mr. LaGuardia. The shrinkage was approximately $1,170,000,000.

Mr. Whitney. That may be very possible. I do not deny it at all.

Mr. LaGuardia. So that there might have been a pool in that particular stock to bring it down.

Mr. Whitney. Are you asking me whether there was a pool?

Mr. LaGuardia. If it is possible?

Mr. Whitney. I have no knowledge of such a pool. May I point out because of my intimate knowledge of the action of that stock, that at all times since it sold in the 70's down to and below $10 a share, there has been the most tremendous market in it on both sides, bids and offers, thereby backing my statement that the important thing is a market, and any owner of that stock at any time that he desired to do so in that period could have received a fair price for his shares if he desired to sell.

Mr. LaGuardia. This is what I can not understand and I wish you would explain it to me. My information is that the highest value of the securities in the portfolio of that company was $267,000,000. How is it possible then that the securities of that company, holding securities of the value of $267,000,000 could be sold to the public in the amount of $1,397,000,000?

Mr. Whitney. Mr. Congressman, you are dealing with a question of values and finance. I have no answer. I do not know that your figures are correct. I do not say that they are incorrect. But I have no information here at hand on that subject.

Mr. LaGuardia. Assuming that my figures are correct, if not substantially correct, then, of course, the public has simply absorbed $1,000,000,000, paid $1,000,000,000 for something they really did not have there, is not that true?

Mr. Whitney. If at the time of purchase it was not there. I do not grant that. If I remember rightly, the stock had a very large increase in value after it had been bought by the public, giving those that originally bought it a chance at any time during that period to have sold it at a profit. I know of no proof that they have not so sold.

Mr. LaGuardia. If all of the property owned by this company was $267,000,000, at the time these people made their purchase, is there any justification for the holding company going out to the public for $1,300,000,000?

Mr. Whitney. I do not know the facts; I can not answer that.

Mr. LaGuardia. I thought you did in this particular case.

Mr. Michener. Brought about by short selling or just simply a question of speculation on margin?

Mr. LaGuardia. Something must have happened to take $1,397,000,000 and have a shrinkage of $1,120,000,000. I am trying to find out. I do not know.

Mr. Whitney. That is self-evident, something that I have stated in my brief this morning. Business conditions have been such; world-wide conditions have been such as to cause general depreciation in business and earnings of corporations and their prospective earnings, in the actual value of existing plants of corporations.

Mr. LaGuardia. True.

Mr. Whitney. Shrinkages have taken place in every business that every man in this room is interested in, I venture to say. I do not know that there is any particular distinction in what has happened to the stock of the United Corporations as against any other—General Electric, Steel, or any of the other large corporations.

Mr. LaGuardia. No. I think that would be applicable if we take the companies represented in the $267,000,000 of securities which the United Corporation held. There, of course, we can easily explain the shrinkage in the value of those securities, but $267,000,000 as compared with the $1,327,000,000 of United seems such a wide range.

Mr. Whitney. I do not know where those figures have been arrived at at all. They sound surprisingly low, but I have no knowledge.

Mr. LaGuardia. Is the stock exchange responsible or answerable to any Government authority at all?

Mr. Whitney. Exactly in what way do you mean?

Mr. LaGuardia. In any way? Is there any supervision over the stock exchange by any agency of the Government?

Mr. Whitney. The stock exchange operates under the laws of the State of New York and also under the Federal laws such as affect its operations or the operations of its members. There are many State laws affecting the operation of the stock exchange and its members.

Mr. LaGuardia. You are not limited in any way to the activities, that is anything not constituting a crime. I mean in your practices you are not answerable to any Government agency. You are not under supervision?

Mr. WHITNEY. Are we talking about the operations of the stock exchange business or the conduct of business by members of the stock exchange?

Mr. LAGUARDIA. The conduct of business by the members of the stock exchange?

Mr. WHITNEY. Certainly. That comes under endless laws of the State of New York. Now, you are getting into the legal end of it. Counsel is here and can help me answer you.

Mr. REDMOND. The stock exchange is an unincorporated association and therefore operates exactly like a partnership. It is recognized as a legal entity and in the laws of the State of New York there is a provision whereby such an association may be sued or many sue in the name of its president or treasurer, but otherwise it is on all fours with a common law unincorporated association exactly in the nature of a partnership.

Mr. LAGUARDIA. You have not any supervision such as the public utility companies?

Mr. REDMOND. Nothing more than a partnership.

Mr. LAGUARDIA. You have no supervision such as the railroads under the Interstate Commerce Commission?

Mr. REDMOND. We have no franchise from the State.

Mr. WHITNEY. I might say counsel and I agree.

Mr. LAGUARDIA. Do you really think that the large amount of short selling in 1931 had no part in the liquidation which caused not only forced selling of securities but scared selling of securities, and even hoarding of money because of the banking situation due to the shrinkage in value of securities and otherwise?

Mr. WHITNEY. That question also has many parts to it.

Mr. LAGUARDIA. It has.

Mr. WHITNEY. I do not think, as I have stated before to-day, that short selling causes declining prices. If declining prices created fear in the minds of people, that fear can not be blamed upon short selling.

Mr. LAGUARDIA. But it was the short selling that created the fear.

Mr. WHITNEY. No.

Mr. LAGUARDIA. You do not even believe that is possible?

Mr. WHITNEY. No.

Mr. LAGUARDIA. Mr. Perkins made reference to several stocks that indicated a period of short selling and decline in prices of the particular stocks. You referred to that in your statement this morning.

Mr. WHITNEY. Two of them.

Mr. LAGUARDIA. Is it not true, taking each stock separately, and referred to generally in your statement—is it not true that in every instance cited by Mr. Perkins we have a given stock at a normal price and then a period of short selling, that indicated the number of shares with an increasing number of shares sold short, that we had a corresponding decrease in the price of the particular stock?

Mr. WHITNEY. I stated in my brief, Mr. Congressman, where I disagree with what Mr. Perkins had stated in his figures, the two exhibits that he presented. I do not agree with them, as I stated.

Mr. LAGUARDIA. But you do not question his figures, only his conclusions?

Mr. WHITNEY. Exactly, yes. It has just been called to my attention here, the testimony of Mr. Perkins with regard to the Fox Film, that the short interest rose, increased, and then the stock was sold at a certain price, and then the price decreased further, although the short position decreased.

Mr. LAGUARDIA. The damage had been done.

Mr. WHITNEY. I do not grant that the damage had been done by short selling; no. You spoke of normal price. The normal price is what the stock will bring or what it is worth, but who is to judge what a stock is worth, $50 or $10, except the judgment of everybody interested in the stock throughout this country and throughout the world. It is that fact that is stated in the market by the buyers and sellers, which to me constitutes that normal price. You spoke of the normal price up here and because it went down it was not normal. I do not agree with you.

Mr. LAGUARDIA. Take the reverse. Suppose it was way up and the normal price is down. Is that wholesome?

Mr. WHITNEY. Certainly.

Mr. LAGUARDIA. That condition is wholesome?

Mr. WHITNEY. Yes. If it came down to the normal price that is wholesome; yes.

Mr. LAGUARDIA. But if it is up, that is not any more wholesome than to have it down below its normal price?

Mr. WHITNEY. You mean, do I approve of wide swings of the pendulum in prices?

Mr. LAGUARDIA. Exactly.

Mr. WHITNEY. No.

Mr. LAGUARDIA. But if it did not have this wide swing, you would not have this enormously large number of transactions on the stock exchange, would you?

Mr. WHITNEY. I am not so sure we would not.

Mr. LAGUARDIA. Suppose we had no short selling, and suppose we had no marginal purchases. Then the stock would remain almost static, would it not?

Mr. WHITNEY. No.

Mr. LAGUARDIA. It would not?

Mr. WHITNEY. The price range in my opinion would be more precipitous upward and downward than without speculation which is constituted by marginal purchase and short selling. I contend that most sincerely.

Mr. LAGUARDIA. How many members are there in the New York Stock Exchange?

Mr. WHITNEY. Thirteen hundred and seventy-five memberships.

Mr. LAGUARDIA. How many out of New York City?

Mr. WHITNEY. Out of New York City? I believe—this is purest guess; I believe some three or four hundred.

Mr. LAGUARDIA. By free and actual working of the law of supply and demand, I believe you referred to that in your statement, do you not mean that the market price rises when buying demand is more insistent than selling supply, and that the market price declines when selling supply is more insistent than supply and demand?

Mr. WHITNEY. Yes.

Mr. LaGuardia. Do you not also mean when you refer to the question of speculation, by the declining prices in speculation or advancing prices, that short selling has the same effect on market values as any other selling of a security?

Mr. Whitney. Yes.

Mr. LaGuardia. When the short seller borrows stock for delivery, is he not permitted to return the identical kind of stock to the lender, and in the meanwhile could the lender have distribution upon that stock?

Mr. Whitney. Yes.

Mr. LaGuardia. During the period of borrowing, does not the lender of the shares still remain the owner of the shares upon the books of his broker and for all purposes of distribution by the corporation which issues the shares?

Mr. Whitney. That is a legal question. If I may answer that question without being held to account for it, because it is legal, I would say that the individual who is long the stock owns that stock against which there is a lien held by his broker, and to that extent he is entitled to the distribution of the corporation.

Mr. LaGuardia. By the delivery of these borrowed shares, does not the purchaser from the short seller become also the owner of those shares on the books of his broker and for the purposes of distribution by the corporation issuing the shares?

Mr. Whitney. May I ask counsel to answer that, in view of the fact that the legality is beyond my ken?

Mr. Redmond. Your first question asked whether the lender of the stock does not remain the owner of it for the purposes of receiving all distributions from the corporation? Of course, the lender of the stock by lending it vests power in the borrower to deliver that stock and divests the lender of the legal title to that stock, but the lender holds a contract with the borrower to replace him in the same situation in which he would have been if he had remained the legal owner of the stock. Therefore, I think the answer to your first question is that the lender of the stock does not remain the owner. He substitutes for ownership a contract right against the borrower. The borrower, which is the second aspect or the second question, if he transfers the stock becomes the owner of record, and, of course, is entitled to receive distribution from the corporation. But both borrower and lender could remain owners of the stock.

Mr. LaGuardia. I am trying to lead up to the illustration of my colleague from Oklahoma and his 500 hogs. As a result, is not a short sale a duplication of the sold shares of the corporation to the extent of the short interest?

Mr. Redmond. No; because, as I have just said, the man who originally held the stock, and lends it, ceases to be the owner of the stock, and substitutes only a contract right for it. In fact, I am familiar with the testimony that short selling increases the volume of securities. I think, where that is wrong, is this: Short selling is a method by which credit is injected into the market but by those men who anticipate declining or downward prices, whereas margin purchasing is where credit is injected on the opposite side of the market. By both methods credit is used for speculation in securities, but this does not manufacture securities or increase the actual supply of securities.

Mr. LaGuardia. They could not possibly do that.

Mr. Redmond. They could not.

Mr. LaGuardia. But they do nominally, do they not?

Mr. Redmond. I do not think so.

Mr. LaGuardia. Would you agree with this illustration? If a corporation has 195,000 shares outstanding and there is a short interest in the stock on a certain day of 139,600 shares, does not that mean that so far as the stock market is concerned, the selling supply of that particular stock has been increased to 334,600 sold shares?

Mr. Redmond. No; because the men who may be short are under obligation to the lenders of the stock to return the stock and, therefore, the people who hold the contracts, the original lenders, have substituted for their stock contract rights which are offset by contract rights or obligations of the borrowers to redeliver, so if you take the net balance sheet both plus and minus of the contract rights you will find that they absolutely cancel, and the amount of the stock of the corporation remains exactly the same.

Mr. LaGuardia. But the public picking up his paper in the morning at breakfast reads that 334,000 shares were sold of that stock.

Mr. Redmond. Yes.

Mr. LaGuardia. And that tends to have some influence on him.

Mr. Redmond. I do not think so. I do not think the public knows the capitalization of corporations.

Mr. LaGuardia. Is that what makes it?

Mr. Whitney. I do not think either that has any effect on the public's mind. May I here interpose for a second? You asked me about those hogs this morning. If there are 5,000 hogs in a particular county, and there are transactions in 500 hogs thirty times in a week, making the total transactions 15,000 hogs per week, and that is resumed and goes on for the ensuing three weeks of that month so that some 60,000 hogs are traded in, in that county, in the month, whereas there are only 5,000 hogs in that county, that is a possibility perfectly legal and along the line you referred to with relation to the shares. But because of the ease for trading on exchanges, all exchanges, not only the New York Stock Exchange, that percentage of trading as to the total capital issue may go up into a very high figure that I spoke about this morning, and as Mr. LaGuardia just referred to now.

Mr. Celler. Is there any difference between that type of credit expansion and the credit that expands on the basis of currency in a bank? Currency in a bank may form the basis for credit fifteen times above the intrinsic value of the currency.

Mr. Whitney. I do not think that you could hardly call the stock transaction or the hog transaction an extension of credit similar to that of a bank.

Mr. Celler. But the principle is somewhat the same.

Mr. Whitney. Somewhat the same.

Mr. LaGuardia. Do you not know, Mr. Whitney, in the protection of the taxpayers and the public, neither a corporation nor its officials can increase its sold shares of capital without complying with definite corporate laws in many instances?

Mr. Whitney. Do I not know that they may not increase? I presume that is the case in any corporation, certainly with those listed on the exchange.

Mr. LaGuardia. Do you not know that an increase in the outstanding shares of a corporation affects the market value of the existing shares and the rights of existing shareholders even though additional money may be paid into the corporation by reason of the increase in shares? For that reason we have the legal picture of preempted rights of stockholders.

Mr. Whitney. Possibly. I understand the legal end of that and possibly it may affect the price of the stock. It may not. Any issuance of additional stock for assets on a parity with what stock is already issued for or for what that stock stands for, may have no effect on the price of the stock or it may very likely increase the worth of the stock in the assets purchased.

Mr. LaGuardia. But if a corporation arbitrarily issues an increased number of shares without increasing its assets, that, of course, would.

Mr. Whitney. That can not be done.

Mr. LaGuardia. It can not be done?

Mr. Whitney. And I do not agree that the increase which you are getting can be shown or exists.

Mr. LaGuardia. What difference do you see, if any, in the effect on the market value in increasing the sold shares of a company through short selling or through additional issue by a corporation?

Mr. Whitney. There is no parity.

Mr. LaGuardia. Is that your answer?

Mr. Whitney. Yes.

Mr. LaGuardia. In all these cases, American Telephone & Telegraph, American Can, Drug, Allied Chemical, National Biscuit, Borden, Corn Products Refining Co., all of the cases stated by Mr. Perkins, you do not question his figures but you take issue with him on his conclusions?

Mr. Whitney. As I stated in my brief this morning.

Mr. LaGuardia. Is it not true that the stock market in its trends upward and downward is largely influenced by the action of certain stocks which are known as market leaders, such as United States Steel, American Telephone & Telegraph, General Motors. and others?

Mr. Whitney. No, sir; not any longer. It was the theory in the past but I do not grant it exists to-day.

Mr. LaGuardia. Is it not also true that there are persons who trade on the floor much more largely than others and who thereby acquire a following, whether upon the bull or bear side of the market, which gives their activities a large effect upon market trends?

Mr. Whitney. Not that I know of. I will answer that further by saying that possibly the correct opinion or advice given by brokers, or banks, or financial advisers, or counsel naturally gives people a following if they are correct. That is natural. That is human nature.

Mr. LaGuardia. Do brokers give advice to their customers?

Mr. Whitney. I do not doubt they try to.

Mr. LaGuardia. Would it be an infraction of the rules of the stock exchange if a broker gave advice to a customer contrary to the real interests of that customer?

Mr. Whitney. Would it be contrary to the rules of the exchange? Yes.

Mr. LaGuardia. Would it be a violation of the rules of the exchange if a broker advised his customer contrary to the interest which that particular broker had in that stock himself?

Mr. Whitney. Yes.

Mr. LaGuardia. What would you do with a case like that?

Mr. Whitney. It would entirely depend upon the evidence and the situation as it proved to be. He is subject to reprimand, to suspension, to almost any penalty, depending upon the offense.

Mr. LaGuardia. Suppose you had a court decision that a member of the stock exchange was carrying on a fraud in permitting his customer to be advised to hold stock when as a matter of fact the broker himself was selling at the time, and the court held it was a fraud?

Mr. Whitney. Are you by any chance referring to the Grace Van B. Roberts case?

Mr. LaGuardia. Yes; I am.

Mr. Whitney. The court was wrong. That was against Hayden, Stone & Co.

Mr. LaGuardia. Hayden, Stone & Co. paid the judgment.

Mr. Whitney. But the court was wrong in its findings. The facts that you have stated here were not true there.

Mr. LaGuardia. They were not my conclusions, a decision of the court.

Mr. Whitney. You asked me a question.

Mr. LaGuardia. Yes. I am quoting now from the decision by the Supreme Court of Ulster County, State of New York, Hasbrouck, judge, in the case of Grace Van B. Roberts against Charles Hayden, Richard F. Hoyt, Gerhard M. Dahl, Jeremiah A. Downs, Frederick H. Baird, Claude W. Peters, Lester Watson, and Arthur C. Sherwood, doing business under the firm name and style of Hayden, Stone & Co., and I read this paragraph:

> The 8,000 shares pool stock were distributed and defendant Hoyt, one of the distributors, sold his participation late in December, 1920, and in January, 1921. But defendants suffered Keays to advise the plaintiff to hold her stock until January, 1922, when Mr. Hoyt advised her to sell it at 30⅛, and to score a loss of over $15,000.
>
> There is no evidence that Hoyt, after having instigated Keays to solicit their customers to buy AGWI—

Mr. Whitney. Atlantic, West Indies & Gulf.

Mr. LaGuardia (continuing):

> ever informed him to tell their customers purchasing under such representation to sell. Why did the defendants keep plaintiff in ignorance? Would the knowledge by plaintiff in January, 1921, that she had been used by her brokers to bolster up their pool have thrown a light upon the use made of customers so purchasing?

That is the decision of the Supreme Court of the State of New York, in which Hayden, Stone & Co. did not appeal, but paid the judgment.

Is it not true that when the matter was brought to the attention of the stock exchange, that Hayden, Stone & Co. was not disciplined, not fined, and as far as I know, are still members of the stock exchange?

Mr. Whitney. That subject has been brought up very recently by a Senator of the United States, Senator Wheeler. I have written him an exhaustive letter on the facts of that case, which with his

permission, I will send copy to this committee, and it states that the essentials of the facts are that Miss Roberts purchased her stock before, a considerable time before, the firm or its partners sold the stock.

Mr. LaGuardia. True.

Mr. Whitney. There were very great changes of opinion, not only in 1920, but occurring on October 24, 1929, and to base a charge of iniquitous dealing upon a man who has changed his opinion, not borne out by the facts, that he had done anything at the time of the purchase by his client that was wrong, would mean that the stock exchange has no fair basis for inflicting penalties.

Mr. LaGuardia. You overlook the fact that the wrong dealing was not committed at the time of the purchase of the stock, but it was committed at the time when one of those members, a partner of this firm of Hayden, Stone & Co., was a director in this particular company, and knew the condition of shipping, knew that the company was out borrowing money, and instructed his customer through Keays to tell the customer to sell their stock, and what I am stating is not my conclusion in this instance but the opinion of that court.

Mr. Whitney. May I refer to my letter of reply to Senator Wheeler, which is very full and goes into all the facts of the case, and why no action was taken by the exchange?

Mr. LaGuardia. The point I am trying to stress in this is that in the face of that court decision, the board of governors or your disciplinary body, did not take action. What assurance has the public that if your recent ruling on loaning stocks is violated, that disciplinary action will be taken against its members?

Mr. Whitney. You cite one case without action by the governors or the business conduct committee. If you care to have me bring the evidence before this committee, I can cite thousands of more cases that have been decided and important cases, in favor of the customer where we felt that the conduct of our members with relation to accounts was such as to demand redress of one kind or another.

Mr. LaGuardia. You do not claim that all your members are righteous?

Mr. Whitney. We think they are.

Mr. LaGuardia. All righteous.

Mr. Celler. They may make errors of judgment.

Mr. Whitney. Yes. That is all.

(The letter above referred to will be filed by Mr. Whitney.)

Mr. LaGuardia. As stated by my colleague from New York, the member of the committee, when I used the word righteous I took that from your speech before the Junior League.

Mr. Whitney. But you picked out a word, not the context. I said that was a word. Thank you.

Mr. LaGuardia. You get righteous men on the stock exchange.

Mr. Whitney. We try to get righteous men as members.

Mr. LaGuardia. It is a laudable ambition.

Mr. Whitney. Thank you.

Mr. LaGuardia. Perhaps a difficult one.

Mr. Michener. The chairman of the committee suggested that you might want to sit down or sit on the table.

Mr. Whitney. I am very happy standing.

Mr. LaGuardia. I did ask in the early part of the afternoon if any member had been disciplined for participating or knowingly taking part in bear raiding since January 1, 1929, and you answered no to that.

Mr. Whitney. Since January 1, 1929, had any member been disciplined for taking part in bear raiding? My answer was no as far as I remember. This case was 1920 that you cited.

Mr. LaGuardia. But the decision was when?

Mr. Whitney. 1924 or 1926.

Mr. LaGuardia. I knew about it for the last three or four years.

Mr. Whitney. So have I.

Mr. LaGuardia. In 1926; within the last three or four years.

Mr. Michener. It seems to me the gentleman is picking out indifferent and unimportant cases and ignoring all the other cases.

Mr. Whitney. That case was decided in 1926 with regard to transactions taking place in the autumn of 1920.

Mr. Oliver. You were president of the stock exchange then?

Mr. Whitney. No; but I was a member of the business conduct committee when that case was brought. I also had it brought to me as president, and 1, 2, 3, or 4 years or more times it has been reviewed by the committee, by myself, and by our counsel.

Mr. Oliver. When was it first brought you attention?

Mr. Whitney. I think about 1928.

Mr. LaGuardia. I want the record to show, in reply to the comment made by my colleague from Michigan, that that case is not an indifferent and unimportant matter. It is a most serious matter, and the Supreme Court has absolutely held there was fraud there, and it is not denied that the matter was brought to the attention of the exchange and no action taken. It seems to me it is quite pertinent to call attention to that case when we have assurance published to the country that the members of the stock exchange will obey the rules recently enacted in regard to the loaning of stock.

Now, Mr. Whitney, you said this morning that the conditions contained in H. R. 4 were so cumbersome that it would be impossible of application. Is it not true that all the papers of this country carry the stock exchange transactions every day?

Mr. Whitney. Yes. Those are taken off the tape. That is quite different from having a report from 1,375 members all over the United States and Canada and abroad.

Mr. LaGuardia. Members know that sales are short, do they not?

Mr. Whitney. By seeking the information, but it is just that seeking and compilation of the information that I say, too, to use your word, is overwhelmingly cumbersome. I never said it could not be compiled, but I said I did not know how long it would take. Perhaps a month.

Mr. LaGuardia. You made the statement this morning that short selling was for a time abolished by the State of New York.

Mr. Whitney. Yes.

Mr. LaGuardia. As a matter of fact, that statute was not obeyed when it was on the statute books, was it?

Mr. Whitney. I think from what we know of it, it was never effective.

Mr. LaGuardia. Like other prohibitions.

Mr. Whitney. Perhaps. We are off that train of thought.

Mr. CELLER. Would you say it could not be made effective, as the law of 1812 was? Were there not violations of it? Was there not so-called bootlegging of stock by parties outside the legitimate exchange?

Mr. WHITNEY. Our records are not sufficient for us to know that fact. I think any legislation of that kind might be evaded by some. Naturally, the stock exchange would have to live up to it.

Mr. CELLER. That happened in Germany.

Mr. WHITNEY. Yes.

Mr. LAGUARDIA. You stated to-day, as well as in your Syracuse speech, that the short-selling accounts averaged about 12,000 daily. Was that your statement?

Mr. WHITNEY. No; that the total short accounts as of a specific date were in excess of 12,000.

Mr. LAGUARDIA. Twelve thousand two hundred and fifty-four.

Mr. WHITNEY. That does not mean those 12,000 accounts traded in any way, shape, or manner on any particular day.

Mr. LAGUARDIA. Have you any records of those?

Mr. WHITNEY. No.

Mr. LAGUARDIA. Would it be available?

Mr. WHITNEY. As to how many accounts traded per day?

Mr. LAGUARDIA. Without giving the names of the short sellers, the kind of stock embraced in each of these sales, and also a statement to show the number of shares of each kind of stock in each such account.

Mr. WHITNEY. That would be a stupendous task. It can be done.

Mr. LAGUARDIA. Would it be possible to file an estimate of the amounts received as brokers by members of the New York Stock Exchange for and during the year 1931 by way of commissions, interest, premiums, and/or otherwise for and in respect of their services in making short sales and short coverings and borrowings and lending stock for those purposes?

Mr. WHITNEY. Would it be possible?

Mr. LAGUARDIA. Yes.

Mr. WHITNEY. I question whether it is even possible. You ask for 1931. I do not know whether the records are even available that far back in our brokerage offices. In any event, sir, it would be a terrific task.

Mr. LAGUARDIA. You do not believe the stock exchange should publish at the close of the business each day, for the information of the public, the kind of shares and amount sold short that day, and similar information as to short coverings?

Mr. WHITNEY. It is an impossibility, an absolute impossibility.

Mr. LAGUARDIA. Do you think also that the names of the persons who have made these sales, those who have made short sales and lent shares for that purpose, as well as those who have covered, should likewise be published?

Mr. WHITNEY. I do not.

Mr. LAGUARDIA. Of course, every corporation must have its stock book which is open to the shareholders in New York.

Mr. WHITNEY. I presume every corporation has its share book. They have a share book that shows the stockholders as of the last record date.

Mr. LAGUARDIA. That is open to shareholders?

Mr. WHITNEY. I believe so.

Mr. LAGUARDIA. And yet you would resist any attempt toward publishing the names of short sellers.

Mr. WHITNEY. I did not say I would resist. I said I did not think it was the proper thing to do, any more than I think it is the proper thing to do, publish the names of all those who have stocks on which they are long or have purchased on margins. We are not resisting anything, Mr. Congressman.

Mr. LAGUARDIA. I should have said "disapprove."

Mr. WHITNEY. I do.

Mr. LAGUARDIA. If short selling is proper and helpful, why is it that on several occasions you have ordered a suspension of short selling on the stock exchange?

Mr. WHITNEY. We have only ordered a suspension once.

Mr. LAGUARDIA. When was that?

Mr. WHITNEY. In September.

Mr. LAGUARDIA. Why?

Mr. WHITNEY. Mr. Congressman, do you want me to read this all over again? It covers that completely. I have made various speeches on the subject.

Mr. LAGUARDIA. No.

Mr. WHITNEY. I think it is fully covered there, Mr. Chairman.

Mr. LAGUARDIA. That is all I want to ask the gentleman.

Mr. MCKEOWN. Mr. Whitney, they have a place in New York called the "curb"?

Mr. WHITNEY. Yes.

Mr. MCKEOWN. Would these bills regulate the curb? Is that a separate trading place which has no connection with the exchange?

Mr. WHITNEY. It is a separate institution.

Mr. MCKEOWN. It is a partnership organization?

Mr. WHITNEY. Under an almost identical set up; not as to the number of members, but almost identical in itself.

Mr. MCKEOWN. What do you mean by a "pool"? Do you mean people who combine together in a joint venture?

Mr. WHITNEY. In a joint venture.

Mr. MCKEOWN. And put that money in there to buy or to sell?

Mr. WHITNEY. I presume so; but none of our investigations have shown a pool for selling short.

Mr. MCKEOWN. Just talking as two citizens of a great country, you realize there is a good deal of feeling about people losing their money in stocks, just like there was about people losing their money in lands down in Florida. There is no law by which you can prevent people from speculating. They go ahead and think they can make money, just as they rush to the oil fields to get into the oil game, or to the gold mines to shovel gold.

Mr. WHITNEY. True.

Mr. MCKEOWN. There is always a bitterness left following a condition of that kind. There is a great deal of bitterness in the country to-day on account of the losses on stocks in 1929. Do you not feel that, if it is possible, your organization and other men engaged in conducting market operations in securities should see what evils might be eliminated by law, and give us the benefit of your opinion about it? I have great respect for your judgment

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when you say that to deprive you of short selling would practically destroy your market. Is there not something that could be eliminated and ought to be eliminated?

Mr. WHITNEY. Mr. Congressman, I do not think there is anything in the world that the New York Stock Exchange would not do, if it knew how, in cooperation or of its own accord, to prevent the swinging of the pendulum up and down, and to prevent the extreme optimism and the extreme pessimism of the people. Please understand that the stock exchange is purely a market. We do not control prices.

Mr. MCKEOWN. I understand that.

Mr. WHITNEY. But in 1928 and 1929 there were constant warnings put out by persons in high office, by research corporations, by people who should know, who had the facts at hand, and yet the public, not only in regard to stocks, but all other commodities, grain and everything, would not take that advice. I reiterate, and I appreciate your very kind words, that anything we could do to cooperate and prevent such excesses in the swinging of the pendulum up and down we would love to do, but we do not know how.

Mr. MCKEOWN. Would not your organization be willing to look around and see if there are not certain practices carried on by people not directly concerned in your market, or in your market place, because your market place, as I see it, could not be singled out; but is there not something that this Congress could help do that would tend to eliminate a good deal of this shoestring speculation that goes on in this country?

Mr. WHITNEY. I can assure you that the New York Stock Exchange will do everything in its power, and is doing it, in looking forward to the future and looking at the present, to prevent what may be called overoptimism or overpessimism on the part of the public; but they do not take advice, even though given by our members or given by others. I assure you that we will look into it and continue to do so.

Mr. MCKEOWN. Then there is this bucket-shop business we hear so much complaint about. Does that have anything to do with the New York Stock Exchange?

Mr. WHITNEY. It had a good deal to do with the New York Stock Exchange, because I think we did away with them. A bucket shop is an absolutely illegal, improper, and crooked form of business.

Mr. TUCKER. When did you get rid of them?

Mr. WHITNEY. I would say, primarily and conclusively in New York, some 10 years or more ago.

Mr. LAGUARDIA. They do make their appearance now and then, do they not?

Mr. WHITNEY. They crop up.

Mr. MCKEOWN. That shows how unsophisticated I am.

Mr. WHITNEY. Our members are not allowed to have any dealings whatever with such organizations.

Mr. MCKEOWN. Is there any way by which Congress could regulate by legislation the brokerage business or that class of brokers that is not regulated by your exchange?

Mr. WHITNEY. I defer to counsel on that, but I think the State of New York—I can not speak for other States—has a very stringent rule as to the type of business that is termed "bucket shops."

Mr. MCKEOWN. There are speculative brokers throughout the country yet, not in the bucket shops, but they assume to sell and give advice on these stocks. They are not under any regulation by your exchange?

Mr. WHITNEY. No; except so far as they have contact with our own members. There we have some control, but I think the securities commissions throughout the many States are doing good work and attempting to have proper laws passed to prevent the wrongdoing in the line that you refer to.

Mr. MCKEOWN. I am just giving you my impressions as I get them from the general public as I come in contact with it. There is a general impression in the public mind that there is something rotten in Denmark, so far as the New York Stock Exchange is concerned.

Mr. WHITNEY. I am afraid we are blamed for it all.

Mr. MCKEOWN. What did they do in 1929 when you had your bull market?

Mr. WHITNEY. As far as I know, they were scared off the roof.

Mr. MCKEOWN. That is all I wish to ask, Mr. Chairman.

Mr. TUCKER. Mr. Tarver, do you desire to ask any questions?

Mr. TARVER. I do not believe so, Mr. Chairman.

Mr. TUCKER. Mr. Celler, do you wish to ask any questions?

Mr. CELLER. You have a governing committee of the exchange, and a business conduct committee?

Mr. WHITNEY. Yes.

Mr. CELLER. What are the functions of those committees, generally?

Mr. WHITNEY. The governing committee is the committee of the exchange that has the ability to pass rules and regulations based on the constitution of the exchange. It also passes amendments to the constitution, which have to be ratified under the constitution by the total membership. It is supreme in control over all other committees. The business conduct committee, as the term implies, has control of the conduct of members in relation to their customers.

Mr. CELLER. In answer to a question propounded by Mr. LaGuardia, and following that question up, would you say there is any harm in having a broker buy short on his own account but long on his customer's account?

Mr. WHITNEY. No; but I want to amplify that answer.

Mr. CELLER. Very well.

Mr. WHITNEY. There is a rule of the exchange that no member who goes short of a stock may use the stock of his customer for delivery against such contract. In other words, if a customer is long of stock, and even if he has signed a loan agreement, no firm or member of a firm, directly or indirectly, may use that stock in meeting his own short contracts. If a firm or a partner of a firm advises a customer to purchase stock when the firm itself is short of it and selling it short, as I answered the Congressman from New York, we would consider that bad business practice and would penalize the man for so acting. If, however, to answer your question specifically, the customer without advice decided to buy stock which the firm happened to be short of, or a member of the firm happened to be short of, that is his own responsibility and his own right.

Mr. CELLER. Mr. LaGuardia referred to the fact that the least fluctuation on the market the better. What would happen if you prohibited altogether marginal trading and short selling? Would there be the least fluctuation or the greatest fluctuation on the market?

Mr. WHITNEY. I think, while the market existed, the fluctuation would be precipitate both ways. I do not think the market would exist very long, and the 17,000,000 citizens of this country who own investments listed on the New York Stock Exchange would have no place whatsoever, except on a so-called gutter market to realize on their securities.

Mr. LAGUARDIA. Does that answer my friend?

Mr. CELLER. It answers my purpose. It may not answer yours.

Mr. Whitney, as I understand it, the following practices now obtain on the exchange, and I will enumerate some six of them: (1) Brokers must now have specific consent to loan trading stock to affect a short sale; (2) brokers must, before executing selling orders, disclose whether they are for long or short accounts; (3) brokers must send in daily reports of their short interests; (4) the practice obtains of the lowest minimum price; (5) the business conduct committee has conducted investigations upon rumors as to bear raiding and stock manipulation; (6) that for two days you temporarily suspended short selling, but in a few instances during those two days you allowed short selling to prevent technical corners.

Now, has the exchange and the business conduct committee done everything reasonable to prevent any bad practices that might obtain on the exchange growing out of short selling?

Mr. WHITNEY. As to those six questions, Mr. Celler, there are certain phases of them that are not absolutely accurate. If you will let this statement of mine go as an answer without my explaining why they are not absolutely accurate. I will answer your last question yes. I believe that the exchange, the governors of the exchange, the committee in particular charge of what might happen under the temporary abuse of short selling, have done everything in their power to prevent illegitimate short selling, which is bear raiding, while allowing short selling which is legitimate.

Mr. CELLER. How old is the New York Stock Exchange? When was it formed?

Mr. WHITNEY. Approximately 1790.

Mr. CELLER. As far as you know, during all that period, has there always been short selling, except when prohibited by the New York State statute?

Mr. WHITNEY. That is something I can not answer during all that time, but so far as I know or can remember back 20 or 30 or 40 years, or 50 years, the answer is yes.

Mr. CELLER. One of the financial writers for the Hearst papers, Mr. Thomas T. Hoyne, commenting on the requirement as to the specific consent obtained from customers to loan their stock, said this, and I would like to have your reaction:

> Strengthening of the market may be the first effect to-day, but the ultimate result is likely to be a reaction, the severity of which would be measured by the intensity and the range of the advance.

Mr. WHITNEY. That was referring to what?

Mr. CELLER. Referring to the limitation on short selling.

Mr. WHITNEY. Referring to this last act of the governing committee?

Mr. CELLER. Referring really to a general limitation on short selling. He said if you go too far in the way of limiting short selling you may have strength in the market first, but ultimately the result is likely to be a reaction, the severity of which would be measured by the intensity and range of the advance.

Mr. WHITNEY. We have always contended, if there were a proper prohibition put upon short selling, the tendency would be for the market to jump up, as it did, as we hoped and expected it would do on September 21, and thereafter, when that fillip to the market had been exhausted, unless there had been some basic change in business conditions to warrant a continuing rise, it would probably fall back and downward.

Mr. CELLER. If you were put under restrictions in respect to short selling, what in your opinion would be the reaction of the banks generally in loaning money on stocks as collateral?

Mr. WHITNEY. If I were a banker, I feel that I would be very careful as to what stocks I would loan money on, and I would increase very materially the margin that was demanded if I was willing to loan at all on collateral stocks.

Mr. CELLER. Why?

Mr. WHITNEY. Because I would feel, as I have stated—I am putting myself in the position of a banker. You asked me the question. I would feel the market would be artificial and eventually would disappear entirely.

Mr. CELLER. Would you say that short selling is essential in order to have a wide and open market for securities?

Mr. WHITNEY. A free and open market, absolutely.

Mr. CELLER. A free and open market.

Mr. WHITNEY. Yes.

Mr. CELLER. I would like to compare the broker who buys long with the broker who sells short. In the case of the long buyer would you say, giving your reaction on that, the long buyers buys before he sells, whereas the short seller sells before he buys, both seeking a profit, the only difference being one of sequence.

Mr. WHITNEY. That is all. I think I said that to Mr. LaGuardia.

Mr. CELLER. Would you say that the principle of short selling was involved in trading in grain futures?

Mr. WHITNEY. Absolutely.

Mr. CELLER. Then I should like to read briefly from a release of the United States Department of Agriculture, under date of September 16, 1927:

> Trading in grain futures offers possibilities of service to producers, millers, and exporters through the opportunity it affords for speculators to make a liquid market where hedging operations, as well as outright purchases or sales, can be promptly made.

Do you agree with that statement, indicating the benefits from trading in grain futures?

Mr. WHITNEY. Yes. I also entirely agree with something very similar to that, which was the result of the investigation of which Sir Josiah Stamp was the chairman, on the subject of short selling and hedging or insurance, as Doctor Huebner referred to it, in Canada.

Mr. CELLER. That was a very recent publication?

Mr. WHITNEY. I think last September.

Mr. CELLER. The statement I have read to you was the contention of Dr. J. W. T. Duvel, Chief of the Grain Futures Administration of the United States Department of Agriculture, in an address given September 16, 1927, at Victoria, British Columbia, Canada, before the Pacific Foreign Trade Council.

Doctor Duvel explained that the speculative character of trading in grain futures is an essential element in furnishing a liquid market for hedging. Trading in futures, if confined exclusively to hedging operations or to contracts consummated by the delivery of actual grain, would be so small in volume, he said, as to be of little value to millers, elevator companies, and others desiring to protect themselves against speculative hazards.

On most of our grain exchanges contracts for future delivery of wheat which are fulfilled by the delivery of actual wheat, Doctor Duvel said, represent only a small fraction of the total volume of trading. On the Chicago Board of Trade the number of bushels of wheat involved in actual deliveries represents less than 1 per cent of the aggregate volume of trading for the year. As a matter of fact, the speaker said, about 95 per cent of the transactions in grain futures made on American grain exchanges are of a speculative character. They are closed prior to or during the delivery period.

This system, Doctor Duvel said, has occasionally given rise to abuses through excessive speculation on the part of individuals of large means and by the general public. He said that excessive speculation generally results in erratic and unwarranted price fluctuations. Steps have been taken, under the United States grain futures act, to correct these abuses, he said, and it is hoped, in consequence, that the futures markets may be made considerably more useful to producers and merchandisers of grain products. He explained that it is necessary to bear in mind the relationship between speculative trading and hedging transactions, since it is recognized that hedging operations can not be successfully conducted through trading in futures without some participation by persons who speculate in futures and thus assume a part of the risk in the hope of making a profit.

A successful hedging market, Doctor Duvel said, must be a liquid market in which a sufficient number of buyers and selling are operating to make possible the prompt execution of orders. In the ordinary course the miller or the exporter is not always ready to buy wheat at a price satisfactory to the producers or merchandisers when they desire to sell. It is here that the futures market exercises a good influence by the opportunity it affords for trading on a speculative basis.

Mr. LAGUARDIA. Will you add, Mr. Celler, that we have a grain futures act?

Mr. CELLER. I did not intend to leave that out. We have a grain futures act.

Mr. WHITNEY. I believe so.

Mr. TUCKER. And also a Farm Board act.

Mr. WHITNEY. I believe so.

Mr. CELLER. Mr. LaGuardia has raised the question of grain futures. I should like to refer to a summary of reports of Commissioner of Corporations of the Departments of Commerce and Labor on the cotton exchange, dated May 4, 1908, and December 4, 1909, wherein language similar to the language used by the Department of Agriculture on grain futures was used with reference to dealing in cotton futures. I shall not burden the committee by reading it all, but I should like to put into the record one or two pertinent paragraphs from this very exhaustive report, as follows:

A particular misconception of the effect of future trading very generally entertained, particularly among producers, is that the system itself, even when properly conducted, necessarily tends to depress the price of cotton, because of the extensive short selling which it makes possible. The mere fact that the total volume of future transactions usually is largely in excess of the crop is urged as evidence that an additional supply is thrown upon the market with disastrous results to the producer.

This prejudice against short selling is largely due to the failure to appreciate certain fundamental facts. The first of these is that every short sale means a purchase at the time; otherwise, of course, there could be no sale. In the second place, every short sale eventually means a subsequent purchase by the original seller. In the third place, this misconception of short selling overlooks the very important fact that speculators seldom undertake deliberately to defy natural conditions; instead, they are as a rule anxious to shape their campaigns in accordance with them. Furthermore, there is usually great divergence of opinion among influential speculators, and almost never complete unanimity of opinion. The prices registered by speculation, therefore, are usually the result of exceedingly keen competition.

* * * * * * *

Instead of constantly depressing prices, short selling often tends to sustain prices. This is because the short seller eventually must complete his transaction either by the purchase of the commodity for delivery on contract or by the purchase of another contract calling for such delivery. Thus short selling really means the creation of a reserve buying power which will make its appearance at a later period. With a large short interest in the market, such a buying power develops immediately on a decline in the price, and should check the violence of such decline, although it may not necessarily limit the ultimate extent of the decline.

It will be seen, therefore, that short selling, far from being necessarily an evil, may at times be productive of very substantial benefit; this is the commonly accepted belief of critical students of the future system.

Furthermore, instead of constantly depressing prices, the future system, when properly conducted, unquestionably tends, within certain narrow limits, to increase the price paid the producer, and this, moreover, without advancing the price to the spinner. This beneficial result of the system is chiefly due to the fact that the hedging system, if properly operated, reduces the risks of cotton merchants. This reduction of risks enables, and indeed, in view of the keen competition which exists in the future market, forces the cotton merchant to reduce his charges for handling the crop. This means either that he can pay the producer more for his cotton than he otherwise would or that he can sell to the spinner for less, or the benefit may be divided between the two interests. As already shown, however, this benefit is dependent upon the proper conduct of the system.

Mr. TUCKER. That is not the grain futures case that went to the Supreme Court?

Mr. CELLER. No; that is not the grain futures case that went to the Supreme Court. I am referring to the report.

Mr. TUCKER. That may be done.

Mr. CELLER. Would you state, Mr. Whitney, that most of the losses on the stock exchange are due to inflated prices?

Mr. WHITNEY. I would not want to express an opinion. That is beyond my knowledge.

Mr. CELLER. Mr. LaGuardia has read a court decision, and I shall refer to one and ask you whether you are familiar with the

case of Hopkins *v.* the United States, reported in 171 United States 578, where briefly the court had this to say:

> The services of members of different stock and produce exchanges throughout the country, in effecting sales of the articles they deal in, are of a similar nature. Members of the New York Stock Exchange buy and sell shares of stock of railroads and other corporations, and the property represented by such shares of stock is situated all over the country. Is a broker whose principal lives outside of New York State, and who sends him the shares of stock or the bonds of a corporation created and doing business in another State, for sale, engaged in interstate commerce? * * * We think it would be an entirely novel view of the situation if all the members of these different exchanges throughout the country were to be regarded as engaged in interstate commerce, because they sell things for their principals which come from States different from the one in which the exchange is situated and the sale made.

Do you gather therefrom that the activities of the New York Stock Exchange are outside the jurisdiction of Congress to legislate thereupon?

Mr. WHITNEY. To answer the first question, I am not conversant with that case, but I feel confident that our counsel is. I do not think I am capable of making the answer.

Mr. LAGUARDIA. Do you hold that is the law applicable to this situation?

Mr. CELLER. I think it is.

Mr. MICHENER. I think the committee can discuss the merits of these cases without the assistance of the witness.

Mr. CELLER. Mr. Whitney, have you seen an article by Dr. James E. Boyle, professor of agricultural economics in Cornell University, in the January issue of Nation's Business, entitled "Short Selling Guards the Market"?

Mr. WHITNEY. No; I have not read it.

Mr. CELLER. I should like to have the privilege, without burdening the committee with it now, to put some extracts from that article in the record.

Mr. TARVER. I shall be obliged to object to articles from magazines and newspapers, all of which are available to members of the committee, being inserted in the record. Suppose you just put a reference to it in the record.

Mr. CELLER. I will be very glad to. That is all, Mr. Chairman.

Mr. TUCKER. Mr. Oliver, do you desire to ask any questions?

Mr. OLIVER. I was thinking of Mr. McKeown's proposition that people are blaming everything on the stock exchange. Is it not a fact that the collapse in the prices and disappointment of the people is the main reason why they are blaming everything on the stock exchange?

Mr. WHITNEY. Very likely; but that is a mere conjecture on my part.

Mr. OLIVER. But the stock exchange has no agency and does not purport to have any to evaluate stocks?

Mr. WHITNEY. None whatsoever.

Mr. OLIVER. You leave that to the public and to the various customers to bid and buy just as they please?

Mr. WHITNEY. Exactly; and provide a market place in which to do it.

Mr. OLIVER. When the stock collapsed from the high to the low, the public started to blame the "shorts" for that. Is that not a fact?

Mr. WHITNEY. I think from a hindside point of view, they blamed the "shorts."

Mr. OLIVER. They blamed the "shorts," whereas, as a matter of fact, if the prices were inflated, they should have blamed the "longs" for having inflated them?

Mr. WHITNEY. And themselves.

Mr. OLIVER. The "longs" and themselves?

Mr. WHITNEY. True.

Mr. OLIVER. But instead of being logical about it, and blaming those who inflated the prices, they blamed those who might have deflated them had they the power at that time—that is, the "shorts"?

Mr. WHITNEY. Yes.

Mr. OLIVER. But when the markets went up, as it did, with a rapid rise, the "shorts" were driven out. Is that not a fact?

Mr. WHITNEY. It so appears.

Mr. OLIVER. They can not exist on a rising market without great peril to themselves?

Mr. WHITNEY. That is true .

Mr. OLIVER. To squeeze the "shorts" out, all you have to do, if you have the power, is to run the price up, and then they have to run to cover and take their losses.

Mr. WHITNEY. Unless they have unlimited cash.

Mr. OLIVER. Unless they have unlimited cash, and their unlimited cash is what is being drawn upon if the prices go up and stay up?

Mr. WHITNEY. That is right.

Mr. OLIVER. They are in great peril every time the prices go up?

Mr. WHITNEY. Does the committee understand just why that is so?

Mr. OLIVER. I do not know. Mr. Condon says he does not. I would like to have you state that.

Mr. WHITNEY. I think that again is a state of mind in many parts of this country which is quite erroneous. If a "short" sells 100 shares of stock at $50, in borrowing those 100 shares for delivery against his contract he has to give the lender $5,000, 50 times 100. If that stock then, instead of going down, as he may have wished or thought it would, goes up to $100 a share, he must, when called upon, deliver to the lender $5,000 more in cash. If it goes up to $150 a share, when called upon by the lender, he has to put up an additional $5,000. Steel is selling in the 40's, and has sold as high as 260; so that example is not ridiculous. If he is short 5,000 shares or 10,000 shares of stock that increases 100 points against him, then he has to put that corresponding amount of cash with the lender as his margin for borrowing stock. Is that clear?

Mr. OLIVER. That is clear to me.

Mr. WHITNEY. Therefore, his resources in cash may conceivably be exhausted, just as the purchaser on margin.

Mr. OLIVER. That is the reason why, when the market rises the "shorts" are driven to cover. Is that not a fact? They want to get way from putting up that additional amount of cash if they sell.

Mr. WHITNEY. If they buy.

Mr. OLIVER. If they buy?

Mr. WHITNEY. Yes.

Mr. OLIVER. A real rising market puts them clear out?

Mr. WHITNEY. Unless they have the cash to maintain their position.

Mr. OLIVER. He is not going to maintain his position while the market is rising, when he can pick it up again at the top?

Mr. WHITNEY. That is a fact, if he can pick it up at the top.

Mr. OLIVER. Unless it were maneuvered, he would have to stay in, if he didn't get out.

Mr. WHITNEY. Probably true; and the reverse with the margin purchaser.

Mr. OLIVER. So, as a matter of fact, the public is now blaming the fall in prices on the "shorts" whereas they ought to blame it on the "longs," in 1929.

Mr. WHITNEY. That is true. And we showed our lack of business judgment in not selling the very stocks that we owned on the market that was provided at all times by the New York Stock Exchange since that period you speak of. We used our own business judgment. We were wrong and we should not blame the stocks.

Mr. OLIVER. The "shorts" interests, as you pointed out, is an infinitesimal interest as against the entire evaluation of the market each day?

Mr. WHITNEY. And very small in ratio as compared to the "long" interests on the market at this and all times.

Mr. OLIVER. How do you protect the public against the "long" interests when they attempt to put stock beyond its value? Do you evaluate at all in those instances?

Mr. WHITNEY. We do not.

Mr. OLIVER. You leave that to the "shorts"? Is that not a fact?

Mr. WHITNEY. To the "shorts" and to the "longs."

Mr. OLIVER. To the "shorts" and to the "longs"?

Mr. WHITNEY. In other words, we leave it to those who are making the market. That is their business. We do not evaluate; no.

Mr. OLIVER. If you turn over to the Government the regulatory process, for the protection of the public, then the Government would have to take some steps toward evaluating stock?

Mr. WHITNEY. If they are going to undertake to say when a stock is too high or too low, yes.

Mr. OLIVER. But what good could the Government do unless it attempted to do that? Is that not the main trouble, that people buy stocks at prices which are too high and they go down?

Mr. WHITNEY. I do not know who is going to take the responsibility. I do not believe the Government would want to take the responsibility of saying that some stock or stocks were worth so-and-so, and if they went down 50 or 100 points have to pay that difference to the purchaser.

Mr. OLIVER. You do not have in your exchange now people of the mental ability to evaluate those stocks as they ought to be?

Mr. WHITNEY. No.

Mr. OLIVER. Then from where would the Government draw in order to get men capable enough to do it?

Mr. WHITNEY. They do not exist.

Mr. OLIVER. When the Government enters into that field, it enters really into the supervision of private business, does it not?

Mr. WHITNEY. Yes.

Mr. OLIVER. Do you approve of the principle of the Government entering into the intimate relationship of customer and seller in private business?

Mr. WHITNEY. I do not.

Mr. OLIVER. If the Government does enact some of these statutes, they would be on the books for a considerable period of time, and will put your association in a strait-jacket for that period of time.

Mr. WHITNEY. That would seem probable.

Mr. OLIVER. And you want to be left alone, but to be criticized by anybody who wants to criticize you, in order to have public opinion brought to you, for the purpose of rectifying anything that is wrong?

Mr. WHITNEY. Absolutely; and we particularly welcome constructive criticism.

Mr. OLIVER. Mr. Chairman, I believe I have nothing further.

Mr. LAGUARDIA. You do not find in H. R. 4 anything that places the burden on the Government of fixing a value of stocks do you?

Mr. WHITNEY. Pretty nearly so; yes.

Mr. CELLER. The Federal Trade Commission would in effect have the right to say "yes" or "no," because of the burdensome restrictions it could impose.

Mr. LAGUARDIA. Why?

Mr. CELLER. They would practically have the right to say that exchange shall not be permitted to deal in "short selling."

Mr. WHITNEY. May I answer Mr. LaGuardia? I said "pretty nearly so." I have read your bill with a great deal of interest. You give the Federal Trade Commission the right to regulate, if they find that such regulation should be undertaken, or the right to say whether or not short selling in stocks shall be prohibited. I think that almost constitutes an evaluation of the worth of that stock.

Mr. MICHENER. Mr. Whitney, as you doubtless know, very few people throughout the country know what the New York Stock Exchange is. I have been especially interested to-day in the statement made by counsel, which in substance is this: That the New York Stock Exchange is composed of a group of individuals associating themselves together for profit; that, so far as the law is concerned, they come within the common-law jurisdiction; that it is not subject to visitation by any regulatory agency of the Government. Therefore, it naturally follows that the association is controlled entirely by its own desires and inclinations, as to regulation.

Mr. WHITNEY. Absolutely.

Mr. MICHENER. And your regulations are public in the sense that you have somewhere a copy of the regulations which an individual so desiring may look at, like a stock book in a corporation?

Mr. WHITNEY. All of the regulations are sent to all of our members when passed, and impressed upon our members when elected to membership, and given the widest publicity when any change is made in them, through the press of the Nation, as I think these gentlemen here will testify. When any changes are made in our rules and regulations, it is given the widest publicity.

Mr. MICHENER. There is no legislation in the State of New York, or elsewhere, to your knowledge, dealing specifically with the regulation of stock exchanges?

Mr. WHITNEY. I do not think so, as to the regulation of exchanges, but there are as to certain practices and to certain classes of brokers, dealers in securities, that may be members of our exchanges.

Mr. MICHENER. I was wondering inasmuch as the New York Stock Exchange deals, not in millions, but billions, and has within its power, unless prevented from so doing by its own act, the ability to control the prices of securities over the country; in other words, hold in the hollow of its hand to-day the economic stability of the securities market of America, if not of the world, with no Government regulation, if it does not seem that the public would have such an interest in an association of individuals engaged in such an expensive undertaking that there should be some regulation somewhere.

Mr. WHITNEY. No. And I will not, I can not, grant that the stock-exchange officials, or the stock exchange as such, has the power to affect the prices of securities listed on that exchange, except by indirection, and that I do not think is a fair point. If we arbitrarily stop short selling, if we arbitrarily stop margin purchasing, or if we arbitrarily do one or the other thing against which we have taken the firmest stand, maybe then we would have the power to affect the prices of securities listed on our exchange. It is our attempt to prevent such regulation, which we would not take of our own accord, that places us in a position of fixing prices on the market place, of preventing anything from happening that would affect the prices of shares on that exchange, regarding which we have no business, that being the business of those who buy and sell and who own those shares.

Mr. MICHENER. I am complimenting rather than condemning, because it seems to me as a practical matter, that these 1,300 members of this stock exchange, as many of them do, in securities, and while you have no interlocking directors as a corporation, it is almost the same thing. It seems to me that you control finance to such an extent that if you did want to form pools, or if you did want to buy short selling or any other plan, ruin a given stock, even like General Motors, it could be done. If that condition does exist, is not the country at the mercy of the honor and integrity and the patriotism of the individual members of the stock exchange? I realize that is rather a complex question.

Mr. WHITNEY. From one point of view that might be so construed, but I have never granted that any group could possibly, by pool operations or otherwise, control the trend of a stock like American Telephone & Telegraph, or General Motors, or United States Steel, or something of that sort. A group might possibly control the trend for a period of a stock of very small capital issue, but the governors of the stock exchange would immediately give their attention to such activities, if they were abuses, and prevent them.

Mr. MICHENER. That gets right back to the question of your integrity and your management and your overseership which I have suggested. But assuming that you should some day have a board of governors who feel differently about the matter than the gentlemen who have appeared before the committee, might not there be a possibility that the thing which I have suggested might happen?

Mr. WHITNEY. Everything in this world is a possibility, but the record of the exchange, I think, in all seriousness, over a period of progressive years, has been for greater and greater stringency in its regulations and in the supervision of the conduct of the business of its members.

Mr. MICHENER. Yes; but I remember when we had almost exclusively private banks in this country. For generations that continued; finally there came a time when the son did not conduct the bank as the father did, and it was thought necessary and advisable to have some Government regulation or supervision over that business, not because of what had gone before, but because of what might happen in the future. I was wondering if this would not be a pretty good time to give some consideration to wholesome regulation.

Mr. CELLER. Do you thing you could legislate honesty?

Mr. MICHENER. That question answers itself. We would not have legislative regulations in any of these matters if we depended entirely upon the golden rule.

Mr. WHITNEY. Mr. Congressman, one word in that connection. I am sorry to take so much time, but just one word in that connection. There are many ramifications to the possibility of regulation of the exchange, many of them, but I want to suggest this one thought: When a member is elected to membership he signs a book in which he specifically agrees to the constitution of the New York Stock Exchange. He specifically gives to the governing committee the right of supervision of his membership and his business life as a member. The word of the governing committee has been held by all courts, and perhaps most recently by Senator Wagner, to be absolute in its findings upon a member, as to suspension or expulsion.

Mr. CELLER. That was when Senator Wagner was a judge in New York?

Mr. WHITNEY. That was when Senator Wagner was a judge in New York. If regulation of some sort or other should be placed upon the exchange, if when penalties were inflicted immediate recourse should be taken to the courts, and the power now existing in the governing committee could be totally dissipated—I do not want to speak personally in such a situation—but I will guarantee to you gentlemen that if regulation of one sort or another takes place, I, for one, and many of my confrères now sitting on the governing committee, would no longer remain in that position of trust, because we would not feel that we could properly carry out that trust with regulation upon us of that kind. I am talking now as a man, and not arguing against the particular bills we have been talking about to-day.

Mr. CONDON. Mr. Whitney, is it not a fact that this public dissatisfaction with short selling did not commence or did not come prominently to the front until President Hoover issued his statement last spring against short selling of grain on the Chicago Board of Trade, and from then on there seemed to be increased publicity stirred up about short selling on all exchanges?

Mr. WHITNEY. No. I think there has been that talk about short selling right from the beginning of 1930.

Mr. CONDON. From the beginning of 1930 and since the stock-market panic, so-called?

Mr. CELLER. Did they not blame the "shorts" for the panic? "Shorts" are blamed for every panic.

Mr. WHITNEY. They always have, and the exchange.

Mr. CONDON. We had to find a scapegoat for the depression.

Mr. WHITNEY. Yes.

Mr. CONDON. For the general depression and panic in the market.

Mr. WHITNEY. Yes.

Mr. CONDON. The most prominent scapegoat was short selling and operations on the New York Stock Exchange.

Mr. WHITNEY. Yes.

Mr. LAGUARDIA. The stock exchange had absolutely nothing to do, directly or indirectly, or even remotely, with the prices of materials.

Mr. WHITNEY. Nothing whatever, directly or indirectly.

Mr. LAGUARDIA. Or any of its members. Of course, I am not talking about the building. I mean the members.

Mr. WHITNEY. I do not mean to quibble, but some people do think the stock exchange is a human force. We are only a building.

Mr. LAGUARDIA. All right.

Mr. WHITNEY. And a market. To answer your question as to its members, that question is world-wide in its scope. I have sold stock that I have been long of and thereby possibly I might have effected the decline of the stock. That may be possible of all of the 1,375 members of the exchange. They may have advised a customer, probably they did, to sell out, or if he got below margin to insist that he sell out. More power to those customers if they got out then, rather than to carry them down to nothing, or whatever prices they may be selling at to-day. But that the militant aggressiveness of members of the stock exchange has caused declining prices, my answers sir, is no.

Mr. LAGUARDIA. Just a moment ago you referred to the membership's book that they signed. As a matter of fact, membership in the exchange is purchased is it not?

Mr. WHITNEY. You purchase it. If you want to become a member of the exchange, you must purchase it from some one or other of the 1,375 members.

Mr. OLIVER. Is it absolute by that purchase? Can the exchange refuse membership?

Mr. WHITNEY. Absolutely.

Mr. LAGUARDIA. How many were refused since 1929?

Mr. WHITNEY. Approximately 8 or 10, I am told. We refuse them frequently. The purchase of a membership means nothing except a contract to pay that amount, if elected by the committee of admissions of the exchange.

Mr. CELLER. Do you supervise the partners of members, who they shall be?

Mr. WHITNEY. Absolutely. We supervise the managers, we supervise the customers' men, we supervise the branch office men. There are many partnerships that are not allowed because of the character of individuals [any] members may propose to take into partnership with them.

Mr. MCKEOWN. Does the board of governors give any thought to the proposition of limiting the amount in the rise or fall of a stock? At any session of the exchange? Have they considered the proposition of limiting the rise of a stock 20 points and not permitting it to go any higher that day, or a fall of 20 points?

Mr. WHITNEY. Yes. That has been considered many times. The feeling is, however, that that causes artificiality and speculation on the down side. Suppose it happened on any day, or on any 15 minutes on some of those October or November days in 1929, that a stock sold to the limit of the range allowed. You [would] immediately have stirred up trouble. What does the banker, what the broker, what does the individual think the stock is worth? Nothing, because the market on that particular stock has stopped.

Mr. MCKEOWN. Some such plan as that exists on the cotton exchange.

Mr. WHITNEY. By Federal regulation, I believe.

Mr. MCKEOWN. Would not a limitation fixing a price either up or down, a reasonable limitation fixing a price up or down, tend to stabilize the price when you reach that point, and it could not go any further that day? Would not that tend to eliminate a good deal of wild speculation that takes place?

Mr. OLIVER. The cotton exchange is the one product exchange.

Mr. MCKEOWN. I understand. That product is on the market.

Mr. OLIVER. You are buying a product, and not stock.

Mr. MCKEOWN. If you have a stock that reaches that point, let it stop and go off of the market that day. It is beneficial, I understand from the witness, to have a more stable market. It is better for the country, better for the exchange, better for all concerned, if these high and low fluctuations do not take place. Then if you take that stock off the market, they will have 24 hours of what we call cooling time to cool either way. Maybe they will not be so keen for it the next morning. It seems there are a lot of fellows you will not let in your exchange. You can not keep them from operating on the public or operating anywhere else.

Mr. WHITNEY. I have already answered that latter question by saying I thought great progress is being made in various States by the securities commissions.

Mr. OLIVER. But there is a great distinction between buying a commodity and buying stock. Even when the stock of a company that makes hats is fluctuating, hats will remain stable in their prices in the stores. They will not fluctuate with the stock.

Mr. WHITNEY. No.

Mr. OLIVER. When you are on the cotton exchange they buy cotton by the bale or ton.

Mr. MCKEOWN. You are just buying a margin.

Mr. OLIVER. But when you buy cotton you are not buying the stocks of a company. You are buying the product, which is a very different thing.

Mr. LAGUARDIA. What legal distinction is there as to the power of the Federal Government regulating one or the other?

Mr. OLIVER. I do not know whether there would be any or not, but a commodity is different from stock. There is a great deal of difference. We had that in the Mellon proposition.

Mr. LAGUARDIA. Still the gentleman made a red, white, and blue defense.

Mr. TUCKER. Are here any further questions? Mr. Whitney, we are very much obliged to you.

Mr. WHITNEY. Mr. Chairman, may I in conclusion say, I want to impress, if I may, upon the committee our position. I want to be very brief. We have the exchange functioning as a market for securities, purely and fundamentally. It must exist, in our opinion. That market is made by investors, buyers and sellers, speculators, margin purchasers, and short sellers. The market must exist and is going to exist, and the trend up and down of that market will be because of the law of supply and demand.

In order to try to prevent a misconception throughout the country in many places that short selling and margin buying affect the trend, I want to say it does not. Speculation, as I said, may smooth out the waves in making for equilibrium and stabilization in a market, but can not affect the tides or the trend of the economic cycle. We stand on the absolute necessity for a market in securities and for the integral parts that make it up.

One other thing. I said to your earlier, and will say again, our counsel, Mr. Redmond is here. If you would like for him to speak briefly or at length on the subject of the constitutionality of these bills to which I have referred, he will be very glad to do so, if you want to hear him now, or we will submit a brief, or both.

Mr. TUCKER. I think the feeling of the committee is that they would prefer a brief.

Mr. WHITNEY. Very well. We will send you the brief and the other papers that I stated would be put in your hands.

May I thank you, Mr. Chairman and gentlemen of the committee, for the really great courtesy you have extended to me to-day.

Mr. TUCKER. That will be all to-day. The subcommittee will adjourn.

(Whereupon, at 4.15 o'clock p. m., the subcommittee adjourned.)

SHORT SELLING OF SECURITIES

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

SEVENTY-SECOND CONGRESS

FIRST SESSION

ON

H. R. 4, H. R. 4604, H. R. 4638
H. R. 4639

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SHORT SELLING OF SECURITIES

FRIDAY, MARCH 4, 1932

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE NO. 3, COMMITTEE ON THE JUDICIARY,
Washington, D. C.

The subcommittee met at 10 o'clock a. m., in room 379, House Office Building, Hon. Tom D. McKeown (acting chairman) presiding.

Mr. McKEOWN. The committee will come to order.

Mr. MICHENER. Mr. Chairman, may I state that I am obliged to go to the Committee on Rules at 10.30 o'clock; and I do not want the witness to feel that I am discourteous in not remaining here to hear him.

Mr. McKEOWN. That is all right. I know that you have an important matter this morning, Mr. Michener.

Representative Luther A. Johnson wanted to make a brief statement, but I do not see him here now.

Mr. Lawrence, how much time do you require?

Mr. LAWRENCE. I think about an hour or an hour and a half.

Mr. McKEOWN. Well, will you conclude in an hour, if possible? We will have to adjourn at 12 o'clock.

STATEMENT OF JOSEPH STAGG LAWRENCE, CONTRIBUTING EDITOR OF WORLD'S WORK

Mr. LAWRENCE. I will try to do so; yes, sir.

I wish, first of all, to identify myself, and to state the auspices under which I am testifying. I served for some years as a member of the faculty of Princeton University, and have since my departure been a writer in a number of capacities. I have written a great deal, and my opinions on this matter before the committee, I think, are well known. In view of that fact, the New York Stock Exchange has asked me to come down here and present my views on this problem of short selling.

Why is short selling on trial for its life to-day? It has been practiced on the New York Stock Exchange for more than a century. Its legality is beyond question under the statutes of New York State. The principle of short selling and the general value of speculation in an organized market have been approved by the Supreme Court of the United States. Short selling or selling for future delivery has been a recognized part of normal market operation in almost every security and commodity exchange in the world. There has been no concealment of the practice. It has been manifest and subject to public scrutiny for years. If there is anything essentially injurious about short selling it has afforded the guardians of public welfare ample opportunity to detect its harmful effects. It has been protected by no special political, religious, or economic interest. In spite of its peculiar susceptibility to attack it has throughout these years managed to remain a cardinal practice in almost every open market in the world.

To-day a hue and cry rises in the land. Excited citizens point to short selling, even as an earlier age in periods of adversity sought for witches and magicians. Here is a practice conducted for many years in the open and treated as respected procedure suddenly placed on trial as a foe of public welfare. How can a practice, sustained by disinterested authorities such as the Hughes commission and the recent stamp commission, at once become sinister and subject to impeachment? Obviously, the answer must be found in the special circumstances which prevail at the time this change in attitude takes place.

The first and by all odds the most important of these circumstances is the profound economic distress from which the world is to-day suffering. The patient who is in pain insists upon an explanation which will reveal the cause. This gives him the satisfaction of knowing the source of his distress. It permits him also to indulge in the hope of a remedy. If the physician who attends offers a complex diagnosis, no matter how correct it may be, it will fail to provide comfort. The answer must be simple, even though it miss the truth by many leagues.

Consider how satisfying short selling is as an explanation of our difficulties. Short selling results in an artificial supply of securities. So starts the popular argument. These are sold in the open market and depress prices. The decline in security prices undermines general confidence. It impairs the value of bank and insurance portfolios. It causes individual fortunes to shrink. Institutions and individuals so affected curtail expenditures. Surplus goods accumulate in warehouses. Men are thrown out of work. Banks fail. In short, we have a depression. All of this seems to be traceable directly to short selling. Hence the remedy. Outlaw the short sale or place it under restraints so onerous as to make it impossible. The first reason then for present hostility against short selling is the ease with which it can be convicted as the cause of our distress.

There is a second reason for the current assault against short selling. Many millions of citizens have lost heavily during the past two years. In some cases this loss has occurred directly in business. In others it has been the result of a decline in investments. Many hard-working men and women have lost in both fields. It is entirely normal for any human being upon being hurt to seek the cause. If that cause can be discovered in some form which will permit punishment, it gives the injured parties, of whom there are now millions, profound relief, although there is no actual reparation for losses.

In other words, short selling is an admirable scapegoat upon whose head we may all read the signs of failure and loss. Particularly is this the case with individuals who have made a living in the sale of advice. There are literally hundreds of financial counselors whose reputations have suffered grievously during the past two years. They were unable to foresee the present and consequently committed themselves and their clients to investments which have resulted in heavy losses. No blame should attach to them for this failure. Economics and particularly the art of forecasting are still far removed from an exact science. Changes are the result of such profoundly complex causes that it is often impossible to anticipate the future.

Very few of us can say that the depression has brought milk-and-honey days upon us. Very few of us can say that it has left us unscathed. This applies, as I shall later show, as much to the members of the financial community as it does to any other single class in the country. For the prophets who predicted undying prosperity and the counselors who placed clients in stocks on the assumption that good times would last forever we may grant every sympathy. What we can not condone is their attempt to place the responsibility for their error upon short selling.

Say these men to their followers, "We were right. We have been right all along. A group of speculators (never named) securing inside information (the precise source and nature of which is never revealed) have deliberately depressed security prices. They have battened on the misery of this fair land and even we, the wise, have not been able to escape." It is an alibi which covers a multitude of errors.

There is a third reason for placing short selling in the defendant's chair. Every act of purchase and sale, every decision to hold a stock as against the decision to sell it rests upon a judgment regarding the future. If I paid $200 for a share of the X corporation, I did so because I felt that the future earnings of this company would justify that price. Furthermore, I was certain that the market would later confirm my judgment and improve upon it to such an extent

that this stock would sell for a price above that which I paid. The course of events demonstrates the error of my judgment. There have been others in the market place who disagreed with me. In fact, it must have been such a stockholder who sold me my shares of X in the beginning. He was right and I was wrong. My conceit is such that I refuse to tolerate this challenge to my judgment. Is there any way in which I can soothe my wounded vanity? By discrediting or outlawing those who had the temerity to differ. I can take no action against those who sold their own stock, but against the short seller who borrowed securities to participate in the market I can level my guns. Now, this opposition to the short seller springs from the same intolerance with which the narrow-minded and the fanatic have always persecuted those of the opposite persuasion.

I do not mean that everybody who criticizes short selling necessarily has that point in mind; but it is nevertheless true that much of the opposition comes from people who resent the challenge expressed in an opposing judgment by a short seller—because, essentially, that is what the short seller does. If you are on the long side of the market and buy a stock, you expect it to go up; the short seller, on the other hand, disagrees with that judgment. He is, in effect, saying, "You are wrong. I am going to match my judgment against yours, and I am going to sell the stock which you are buying." Now, if he is right, the fact will be demonstrated by the event.

Mr. OLIVER. Is the short seller engaged in propaganda to bear down the prices of stocks?

Mr. LAWRENCE. I am sure that point will come up later.

To continue, we may sum up the reasons for the present assaults against short selling as follows:

First, it offers a plausible explanation for the depression.

Second, it provides a satisfying scapegoat for those who have lost during the past two years and is a grand alibi.

Third, it is a balm for the wounded vanity of those whose market judgment has been in error.

To what extent is short selling a cause of the depression? A cause must always precede an effect. It is impossible to have a fire without prior combustion of fuel, a blow without an earlier application of force, or hunger without previous denial. If short selling is the cause of the decline in business and stock prices, we must find evidence of substantial short selling before the turn in business and earnings started. The critics maintain that short selling before the crash of 1929 was of little benefit in checking the rise, although disastrous in accentuating the decline. The turning point seemed, according to this analysis, to come spontaneously, and, once started, short selling by artificially depressing prices caused business to languish and finally reach its present state. Now, stock prices always respond in the end to two conditions—first, the state and trend of business and, secondly, the level and direction of corporate earnings.

If you will take these charts [indicating] and please follow me in this discussion, I think we can explain this next point a little more clearly.

EXHIBIT ONE

INDICES OF INDUSTRIAL PRODUCTION AND INDUSTRIAL STOCK PRICES

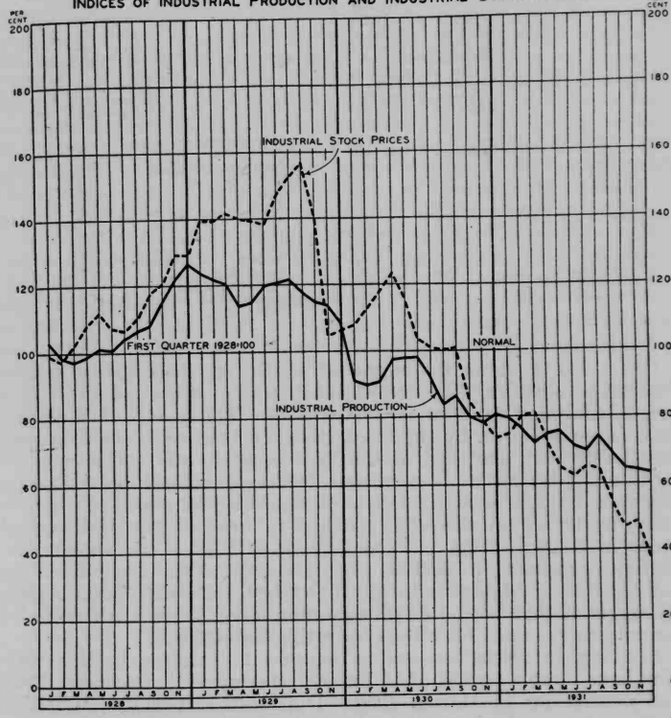


EXHIBIT 1

Comparison of industrial production and industrial stock prices

	World's Work Index of Production (revised so that first quarter 1928=100)	Standard Statistics Index of Prices of 337 Industrial Stocks (revised so that first quarter 1928=100)		World's Work Index of Production (revised so that first quarter 1928=100)	Standard Statistics Index of Prices of 337 Industrial Stocks (revised so that first quarter 1928=100)
	Per cent	*Per cent*		*Per cent*	*Per cent*
1928—January	103.6	99.6	1929—January	124.0	139.8
February	98.9	97.7	February	122.0	139.7
March	97.5	102.7	March	120.8	142.1
April	99.0	108.5	April	114.2	140.4
May	101.6	112.3	May	115.0	139.9
June	101.1	107.8	June	120.0	138.7
July	104.6	107.1	July	120.9	147.1
August	107.0	110.8	August	121.9	152.7
September	108.3	117.9	September	118.0	157.0
October	115.5	120.8	October	115.2	141.0
November	122.0	129.8	November	114.1	105.0
December	127.0	129.5	December	108.8	106.6

Comparison of industrial production and industrial stock prices—Continued

	World's Work Index of Production (revised so that first quarter 1928=100)	Standard Statistics Index of Prices of 337 Industrial Stocks (revised so that first quarter 1928=100)		World's Work Index of Production (revised so that first quarter 1928=100)	Standard Statistics Index of Prices of 337 Industrial Stocks (revised so that first quarter 1928=100)
	Per cent	*Per cent*		*Per cent*	*Per cent*
1930—January	91.3	108.0	1931—January	79.7	75.0
February	90.2	113.0	February	76.4	80.1
March	91.0	118.2	March	72.6	81.0
April	97.9	123.8	April	75.0	72.8
May	98.1	116.2	May	75.7	64.8
June	98.3	104.0	June	71.8	62.6
July	92.2	101.4	July	70.2	65.1
August	84.1	100.6	August	74.4	64.1
September	86.9	101.1	September	69.5	55.0
October	80.1	85.4	October	65.0	47.0
November	78.1	78.7	November	64.0	48.9
December	81.0	73.9	December	63.6	[1] 37.6

[1] Jan. 2.

Chart No. 1 shows the course of industrial stock prices and industrial production. The dotted line on the chart is an index of stock prices, compiled by Standard Statistics. The index of industrial production is shown by the black line. In both cases the first three months of 1928 are used as the base equal to 100. The index of industrial production is corrected for seasonal and price changes as well as normal growth. Production reached its peak in December, 1928, made an unsuccessful attempt to break through this high point in August, 1929, and has since then with a few abortive exceptions continued to decline. Stock prices on the other hand did not reach their highest point until October, 1929, nine months later. Throughout that period of nine months other forces than declining security prices must have been operating on business.

Starting in December—let us express the matter in this way: You have there a period of 15 months, staring with December, 1928, and continuing to March, 1930. During that period production, starting from a high point in December, 1928, reaches a low point in March, 1930. That is a period of 15 months. Throughout that period you have rising security prices for 13 of these 15 months; in other words, security prices dropped only during October and November of 1929.

Mr. OLIVER. May I ask you to give us an explanation of the dotted line and the plain black line?

Mr. LAWRENCE. The solid line represents production.

Mr. OLIVER. Production?

Mr. LAWRENCE. It represents the output of a number of different lines of business in America.[1] The broken line is the average of 404

[1] The index used here is the World's Work Index of Production based upon the following series:

	Weight
1. Construction	14
2. Bituminous-coal production	3
3. Crude-oil output	1
4. Cotton forwardings	4
5. Cotton cloth production	1
6. Carloadings, commodity	5
7. Electric-power production	3
8. Steel activity	15
9. Automobile production	6
Total	52

stocks, as computed by Standard Statistics. So that you may say, in effect, that the dotted line represents security prices and the solid line represents business, in so far as it is possible to measure both. Neither one of these is perfect, you understand, but they do give you some approach to the changes that have taken place.

Now, bearing in mind the premise that the cause must precede the effect, if short selling was the cause of the business depression, then it must have brought about, first, reduction in security prices, and, second, the decline in business. You will note that it is quite impossible for short selling, acting as a destructive force in the market, to disturb business sufficiently to pull it down; because the intermediate factor, declining security prices, was not apparent in that period.

During the 15-month period from December, 1928, to March, 1930, you had a general decline in industrial production, yet October and November, 1929, are the only two months in which short selling could apply. During the four months, after November, 1929, stock-market prices were rising. That was ineffective in bringing about a business revival. Business dips very decidedly from the end of the year down through March of 1930.

You have a period there of 15 months, from December, 1928, to March, 1930, in only two of which you have declining security prices, and in only two of which, therefore, short selling could be a factor; and yet during this entire 15-month period, there is a definite downward trend in business. Now, if short selling operates to bring business down, it was certainly not operative in this period. The decline in industrial production from December, 1928, to March, 1930, was 22.8 per cent. The net decline in security prices during the same period was 10.2 per cent. In other words, the evidence indicates that the stock market, in so far as it is an institution reflecting values, has failed to show an improvement because business itself did not contain the necessary elements of improvement.

EXHIBIT 2

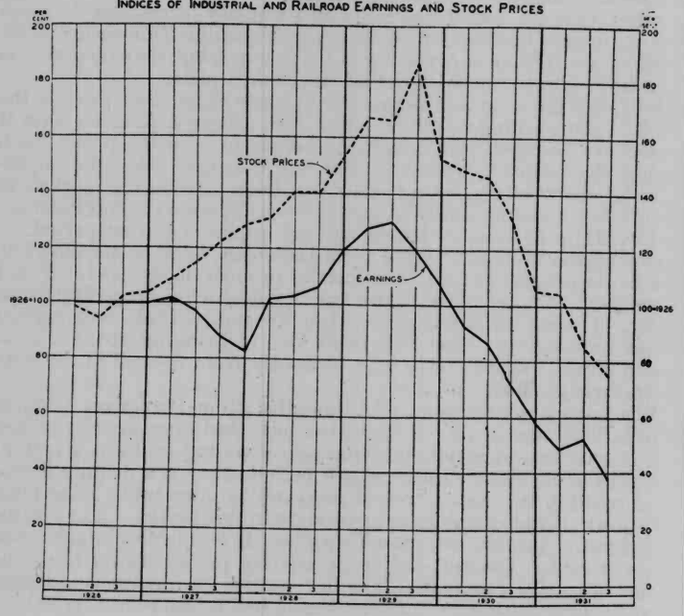
Aggregate net earnings of 163 industrials, by quarters

[Compiled by Federal Reserve Bank of New York]

	Actual figure	Adjusted index, 1926=100		Actual figure	Adjusted index, 1926=100
1926		*Per cent*	1929		*Per cent*
1	$246,000,000	100.0	1	$344,000,000	139.8
2	278,000,000	100.0	2	414,000,000	148.5
3	282,000,000	100.0	3	393,000,000	139.1
4	230,000,000	100.0	4	284,000,000	123.4
1927			1930		
1	253,000,000	102.8	1	265,000,000	107.7
2	288,000,000	103.5	2	276,000,000	99.4
3	258,000,000	91.5	3	204,000,000	72.4
4	195,000,000	84.8	4	116,000,000	50.4
1928			1931		
1	263,000,000	106.9	1	125,000,000	50.8
2	322,000,000	115.8	2	159,000,000	57.2
3	343,000,000	121.5	3	97,000,000	34.4
4	301,000,000	130.8			

EXHIBIT TWO

INDICES OF INDUSTRIAL AND RAILROAD EARNINGS AND STOCK PRICES



Aggregate net earnings of 172 Class I railroads

[Compiled by Federal Reserve Bank of New York]

	Actual figure	Adjusted index 1926=100		Actual figure	Adjusted index 1926=100
1926		*Per cent*	1929		*Per cent*
1	224,000,000	100.0	1	260,000,000	116.0
2	272,000,000	100.0	2	304,000,000	111.8
3	394,000,000	100.0	3	397,000,000	100.8
4	342,000,000	100.0	4	314,000,000	91.8
1927			1930		
1	227,000,000	101.2	1	176,000,000	78.5
2	247,000,000	90.8	2	200,000,000	73.5
3	336,000,000	85.3	3	283,000,000	71.8
4	276,000,000	80.7	4	226,000,000	66.1
1928			1931		
1	217,000,000	96.9	1	107,000,000	47.7
2	245,000,000	90.1	2	132,000,000	48.5
3	358,000,000	90.8	3	167,000,000	42.4
4	373,000,000	109.1			

Indices of stock prices

[Compiled by Standard Statistics Co.]

	Stock prices of 337 industrial corporations, 1926=100	Stock prices of 33 railroads, 1926=100		Stock prices of 337 industrial corporations, 1926=100	Stock prices of 33 railroads, 1926=100
1926	*Per cent*	*Per cent*	1929	*Per cent*	*Per cent*
1	100.3	96.9	1	193.6	141.3
2	94.0	95.5	2	192.3	140.6
3	102.4	103.1	3	209.7	164.5
4	103.3	104.5	4	162.0	142.8
1927			1930		
1	107.2	110.3	1	155.9	140.7
2	112.5	117.7	2	158.0	134.1
3	122.6	123.0	3	139.3	122.7
4	131.4	125.3	4	109.4	102.2
1928			1931		
1	137.8	124.3	1	108.4	100.8
2	150.9	130.2	2	92.1	79.4
3	154.2	126.9	3	84.7	65.9
4	174.5	132.7	4	61.4	42.0

Comparison of earnings and stock prices

	Indices of stock prices of 337 industrial corporations and 33 railroads, 1926=100	Indices of earnings of 172 railroads and 163 industrials, 1926=100		Indices of stock prices of 337 industrial corporations and 33 railroads, 1926=100	Indices of earnings of 172 railroads and 163 industrials, 1926=100
1926			1929		
1	98.6	100.0	1	167.5	127.9
2	94.8	100.0	2	166.4	130.2
3	102.7	100.0	3	187.1	120.0
4	103.9	100.0	4	152.4	107.6
1927			1930		
1	108.8	102.0	1	148.3	93.1
2	115.1	97.2	2	146.0	86.5
3	122.8	88.4	3	131.0	72.1
4	128.3	82.8	4	105.8	58.3
1928			1931		
1	131.0	101.9	1	104.6	49.3
2	140.6	103.0	2	85.8	52.9
3	140.6	106.2	3	75.3	38.4
4	153.6	120.0			

The second chart provides a comparison of stock prices and earnings. In both cases 1926 is used as the base. Earnings are adjusted for seasonal changes. Average stock prices for each quarter are plotted. It may be seen that stocks continued to rise in 1927 in spite of a decline in earnings for the second, third, and fourth quarters. In the absence of declining security prices what could have caused earnings to fall off in this manner?

Allow me to state the simplified syllogism which is used to support the theory that short selling causes business to decline: Short selling throws an artificial supply of securities on the market. Security

prices are depressed, thus bringing losses to institutions and individuals all over the country. Please note that short selling first of all must produce declining security prices.

Now, you will note here [indicating on chart] that during the third quarter of 1929 stock prices made a sharp gain and touched their postwar peak while earnings fell off. You can not pick on short selling as the cause of that decline in earnings, because in that third quarter of 1929 stock prices made their sharpest gains, whereas earnings had started to fall off in that third quarter.

Mr. OLIVER. Well, perhaps the short sellers were "busted" then?

Mr. LAWRENCE. Possibly they were. They tried to anticipate what was going to happen. There is no doubt that during that period the short seller had come to the conclusion, since proved mistaken, that stock prices had reached their top. He matched his judgment against others and lost.

The rate of decline of earnings and prices thereafter is roughly similar with earnings leading the way. At the end of the third quarter of 1931 stock prices were 94.7 per cent below the level of 1926 and earnings 61.6 per cent below. In other words, earnings had dropped off far more from that base period than stock prices—and this in spite of any influence that short selling might have had.

How can it be said that the stock exchange in permitting short selling has encouraged an undue deflation in security values?

The decline in security values is due not to short selling but to the extended liquidation of securities by holders who felt previously established foundations of confidence disintegrating in a disturbed world. Many citizens infected in better years by the psychology of extravagance are now smitten by its fallacy. Incomes were spent before they were received and increases anticipated which failed to materialize. The optimism which expressed itself in new era philosophy was repudiated in favor of a dour realism which has brought us to another extreme. Excessive productive capacity in the world's great industries, governmental tampering with the natural play of economic forces, the accumulation of indigestible stocks of raw materials, the maladjustment of production and consumption, the reparation issue and the unbalanced state of international economy are all items in that great account which the world to-day is trying to settle. To say that short selling, a method of expressing a judgment on the fundamental factors of business and investment approved by the Supreme Court of the United States, by the Hughes Committee and more recently by the Stamp Commission, ranks with these as a cause of the depression or takes precedence over them is to ignore the plain truth and court an illusion.

On the positive side what useful functions does the short sale to merit the support of its defenders? Short selling is a method whereby a legitimate entrant in the market may oppose his judgment of values against that of others. To hold a value for an object which differs from that of your neighbors is no offence against community morals, welfare or the free and fair functioning of the market place. No exchange of any kind can ever take place unless two parties meet who have a difference of opinion regarding the value of the objects in trade.

Take for illustration the case of a youngster who wants to buy a cone of ice cream. This chap has a nickel, which he prizes, but not as highly as the ice-cream cone; in his own mind, the ice-cream cone is worth more than the coin. The vendor of the ice cream, on the other hand, has entirely different notions; he would prefer to have the coin. The two get together and the transaction is consummated. Both parties have gained; each one has obtained something of greater value for something of lesser value—that is, in his own judgment—the vendor thinks the nickel has more value, and the boy thinks the ice cream has more value. Thus the exchange takes place. And that is the essence of all trade—namely, that both parties at the time must have the conviction that they are gaining, because otherwise there is no occasion for them to make the exchange.

Mr. OLIVER. Except necessity.

Mr. LAWRENCE. Yes—except, of course, necessity.

Mr. CONDON. And you would argue that, wherever there is complete freedom of trade, this argument of yours will prevail?

Mr. LAWRENCE. Yes; that is true.

A market is a meeting place of many people all of whom have some opinions regarding the value of the objects to be traded. It is the difference of opinions which gives the market volume and makes trading possible. The short seller opposes his judgment against that of the group which holds stock, is buying it or intends to buy it. In selling a hundred shares of United States Steel to a buyer a short seller says in effect, "You are overvaluing this stock and undervaluing the dollars offered in payment. I think the stock is worth less and the money more. I will be a bull on the purchasing power of money and you a bear. You will be a bull on the exchange value of this stock and I a bear."

In other words, it is the matching of judgment against the value of a share of stock and of the money. If I sell a man a share of stock at $100, I do so because I think the $100 will be worth more, as compared with the stock, than it is to-day; in other words, I am a bull on the money. Whereas the other fellow buys it because he thinks that, at some time in the future, the stock will be worth more as compared with the money; he is a bull on the stock; he is a bear on the money. He thinks that some time in the future the dollars which he is paying will be worth less than they are at the present time. It is a series of judgments applied to these two things that are exchanged between the two parties.

The fact that the short seller does not have title to the stocks he sells at the time neither denies him the right to express this judgment nor does it impair the value of that judgment in making a market. The act of selling short plays just as important a part in establishing a true concensus of value for a share of stock as the sale by the owner.

Mr. OLIVER. But does not the short seller buy?

Mr. LAWRENCE. Yes; he buys later on.

Mr. OLIVER. He borrows first, and then he buys in the stock at some time later on?

Mr. LAWRENCE. That is right. First, he sells the stock, and must borrow the stock which he sells. At a later time he steps in and

buys an equal amount of stock and returns it to the man from whom he has borrowed it.

Mr. OLIVER. That is, at a later time?

Mr. LAWRENCE. At a later time. Express the matter in this manner. If you have an opinion that a certain stock at $100 a share is selling at a higher price than it is worth—or let us assume that it is a share of United States Steel Corporation stock, and make it $50 a share, to accord with conditions to-day. Suppose you have made a study of the steel industry. You think that, owing to the conditions in the automobile trade and other trades which use steel, the steel industry faces a period of depression; that anybody who buys United States Steel at 50 is paying too much for it. Now, that is your opinion. You have a right to match that judgment against the market, provided you pay for it; and you assume certain risks. You step into the market and express that judgment. It is only a judgment. There are many others in the market at the same time who agree with you. Some disagree with you. There is no true way of determining the truth except by having these various individuals step into the market and work out a consensus of value. That is the purpose of a market place.

Furthermore, the short seller has a stronger conviction in the accuracy of his judgment than the trader who sells from his own strong box—if we may judge the strength of these convictions by the penalties paid for errors.

Let us take a share of United States Steel. One man who owns it sells it at $40. He sells because he thinks the share is worth less than $40. Another man borrows a share and sells it for the same price. He also sells because he thinks the share worth less than $40 and is confident that the market will later corroborate his judgment.

Assume now that these two men are in error and that the market rises during the week to $45. The erstwhile owner of the share has lost $5. The short covers and has an initial loss of $5.

In selling short he had to deposit $15 with his broker as a margin. Throughout the week the stock was loaning at an average premium of one-fourth of a point, 25 cents a share; that is to say, during every day that this man had this stock sold and uncovered, he had to pay 25 cents for the privilege.

If this stock is transferred in the meantime—let us assume that during this week the stock which I have borrowed from you I sell to somebody else, and during that week the corporation takes note of the stock ownership on its books, for the purpose of paying dividends; and after the stock is transferred the man to whom I have sold it notes his name on the books, let us say, John Smith. The corporation pays the dividend to John Smith; and you, who have loaned the stock, do not get the dividend. Therefore, to protect you, I am under obligations to make that good, and if any dividend is paid during the period for which I have borrowed that stock, I must pay it to you.

Mr. OLIVER. In other words, the broker stands surety for that, and he must collect from his customer?

Mr. LAWRENCE. Yes; he takes care of that out of the margin that I have deposited with him; so that you as the owner of the stock

that I have borrowed in order to sell to John Smith, are protected at all times.

Mr. OLIVER. That is, under the rule of the stock exchange?

Mr. LAWRENCE. Yes, sir.

Mr. OLIVER. The broker can not "fall down"?

Mr. LAWRENCE. The broker can not fall down. The broker must maintain that surety, because the broker acts as the agent for the customer.

Mr. OLIVER. He is agent for the exchange, besides being agent for the customer?

Mr. LAWRENCE. That is right; he is agent for both.

The man who sold short lost $5, the commission in buying the stock back, interest on his $15, the premium on the stock, $1.75, and possibly a 50-cent dividend. On a 100-share lot and assuming 3 per cent interest on money this short paid $705.86 for the privilege of voicing his erroneous judgment. This is $190.86 more than the actual owner of 100 shares would have paid for the same error and we have not counted in this the possibility of a dividend payment, which raises the penalty to $755.86.

The short seller is no impertinent interloper in the value making process. His risk is greater than that of an owner and he pays handsomely for the privilege of the market place.

Some of the resentment directed against the short seller is the result of a grave misapprehension regarding the nature of value. His challenge tossed into the market place is repeatedly described as an assault upon values. The statement implies certain immutable and intrinsic qualities in value to question which is impious. Every buyer and seller who participates in the market, no matter how he consumates his bids, whether by borrowing money to complete payment, borrowing stocks to complete delivery, paying or delivering out of his own resources questions not only the judgment of the other party to the transaction but the prevailing price.

The distinctive qualities of value are not in its fixity but its fluidity, not its objectivity but its subjectivity.

Now, that is very abstract. Let me enlarge a little on that point. I think many of us have a notion that value is something that is absolute, and that you can apply a yard-stick to measure it, or that you can place it on scales and weigh it.

Now, as a matter of fact, value is nothing of the kind. It is simply the reaction which certain forces have upon us who are thinking of buying something, or thinking of selling something.

In the case of United States Steel, for example, suppose we happen to know that back of every share of stock there is a book value of $200. We know also that back in 1929, United States Steel sold for $261 and over. During the course of the past few months, United States Steel has dropped as low as $35 a share.

The point is, that the people who are buying and selling United States Steel varied in their judgments of its value; that the industry itself created certain impressions which were purely mental and subjective and represented states of feeling on the part of the people who were buying and selling. And those states of feeling continued from day to day and from month to month.

Value is of that nature. It changes constantly, and there is nothing absolute or fixed about it. You understand that, if favorable news comes out on the stock exchange, the price of the stock bounds upward, but that does not affect the basic qualities of the stock; it is simply that people have acquired a conviction that these stocks are worth more.

Value is the resultant of the estimates of eligible buyers and sellers directed upon an object at any moment. Eligibility is established by the ability to buy and sell, the assurance of delivery, either of money or stocks, and the willingness to assume the risks of erroneous judgment. The fact of ownership is in no sense essential. If I believe a certain stock is undervalued in the market place and pledge my credit in order to enter my judgment, in other words, if I buy on margin, I lose no less and gain no more in the event of a change than the man who owns it outright. If I believe the same stock is overvalued and pledge my credit in support of my conviction, in other words, if I sell short, I can gain no more in the event that I am right, but may lose more in the event I am wrong than the man who owned the stock and sold outright. As a margin trade on either side I am at least as susceptible to injury as the man who buys or sells outright.

Mr. OLIVER. Can a man whose stock is borrowed ever lose if the price goes up? Is he ever put in a position of losing by a short who can not cover?

Mr. LAWRENCE. I do not beleive that has ever occurred—although it is conceivable that it might. It might occur under these circumstances: A stock might go up to a price that was entirely unexpected, and the margin of the man who borrowed it might be insufficient to cover the difference between the price of the stock at the time it was sold and the price at which it is bought back. Then, in addition to that, you might have this situation——

Mr. OLIVER (interposing). Is the broker then responsible, too?

Mr. LAWRENCE. Yes; I am coming to that. In the event that the broker, for some reason, is in such a poor position, with his other commitments so great that he can not meet them, it is conceivable that the man who had borrowed might lose. But that has never occurred.

It is no crime to question a value. Value is merely the capacity to gratify as measured by a group of buyers and sellers at any given moment. It is as ephemeral and elusive as happiness and acknowledges no standard. Even an object with such a stable foundation as a share of United States Steel touches amazing extremes within a short period of time. It seems incredible in retrospect that buyers and sellers in an open market should have paid $260 for a share of this stock. It is possible that another day may come when the present price will seems equally fantastic. The market value at any time is the appraisal which market participants make of the future. This future is compounded of many elements, the probable earning power of the stock, alternative investment opportunities, the money rate, the purchasing power of the dollar, the marketability of the security and its resistance to price fluctuations as well as many special considerations which a particular buyers or seller may bring to bear.

There is no formula which can weigh these factors, much less establish a common denominator that will determine the intrinsic value of a share of stock. That value is an act of judgment, and every man and woman who subscribes to the conditions of eligibility has a right to express that judgment. The greater the number of participants the greater the approximation to the true value which it may possess at the time.

In other words, if I can go with a house that I have for sale to a thousand possible buyers and describe this house to them, certainly among that thousand possible buyers I will find a great many who are interested in it and will express some judgment about the value of that house, in terms of dollars. And in that way I stand a much better chance of securing for that house the true value than if I were compelled to take it and offer it to a particular individual on the street and nobody else. The first man I talk to might not care for that kind of a house, but he might buy it in the expectation that he would be able to sell it at a later time at a higher price. And in the case of the stock market, you can multiply the number of people who might be interested in that by the thousands—in fact, on the stock exchange it would be increased to millions, and you would stand a much better chance of finding the true value of the thing offered for sale. And that is the reason why the stock exchange is so insistent upon the freedom of the market and the right of the short seller to come in and express his judgment, because it adds to the number of people who are in that market expressing their judgments of value.

Mr. OLIVER. You do not make a contention that there is no way to find out that a stock is very much inflated in value?

Mr. LAWRENCE. I beg your pardon?

Mr. OLIVER. You do not contend that there is no way of finding out that a stock is very much inflated in value, do you? There are certain extremes that anyone acquainted with the stock would recognize. Is that not so?

Mr. LAWRENCE. That is true; yes; but they recognize it much better after the time has passed——

Mr. OLIVER (interposing). Well, do you not think that the officers and boards of directors of corporations know pretty well what the value of their stock is from their earnings?

Mr. LAWRENCE. They think they do. The only thing is that they are calculating without the help of the market. I know of cases in 1929 where officers of corporations felt that the stocks of companies with which they were connected were selling at too high a price, and they went in and sold short and " went broke " doing it.

Mr. OLIVER. Sold short, yes; but that is different; they were gambling with the price, and betting that it would go down.

Mr. LAWRENCE. But it was their judgment, and it was an honest judgment; and they paid the penalty for the error.

Mr. OLIVER. But my point is that not many of the officers of the corporations warned the public that their stocks were stretched out to the capacity of a bubble; is not that true?

Mr. LAWRENCE. I think it is true that warnings were given. You see a man on a board of directors of a corporation is in a very delicate position, and he can not very well go out and tell the public,

"Gentlemen, the stock of the company in which I am a director is selling at too high a price."

Mr. OLIVER. But General Harboard did it, and Giannini did it?

Mr. LAWRENCE. Yes; that is true. Giannini did it.

Mr. OLIVER. Yes; he said, "This is in the hands of speculators, and I advise the public to look out, because it will surely collapse."

Mr. LAWRENCE. Yes; that was an extraordinary act on his part.

Mr. OLIVER. And you regard it as a kind of act you would like to see performed by American business men?

Mr. LAWRENCE. It is certainly up to him if he is a member of the company, and if he expresses that judgment it is entitled to a great deal of weight.

Mr. OLIVER. But what I am trying to point out to you is that there are others besides the shorts who are responsible for depression in the market; that is, those who allow their own stock to go up away above its value, and the public is treated like a lot of "suckers"—when they know that when it goes up it is bound to go down—I think the American business man has a big responsibility for the collapse, because he lets the stock go up and be stretched to "bubble" capacity, with full knowledge of the way it was going.

Mr. LAWRENCE. Yes; but you will realize the danger of a man going out and advising the public not to buy the stock of his company.

Mr. OLIVER. I have known of cases where a real-estate agent would say to a woman who was thinking of buying a certain piece of property, "Do not buy my property at that price; you can not make it good at any such price; it is ridiculous; the price is too high." I have seen little "2-penny" people who would do that—it is only common honesty.

Mr. LAWRENCE. That works out better in the case of real estate than it would on the stock market. But if I were a director in the United States Steel Corporation, and you were buying its shares at $210, and I did advise you that way, and then the stock should go up to $220, I would feel very badly.

Mr. OLIVER. Yes; but suppose there is only 2 per cent of earnings coming in on the stock of the corporation, in place of 50; and the stock goes up to $250. Is that not some indication to an intelligent business man that there is something wrong in the price of the stock; it would indicate that to you, would it not?

Mr. LAWRENCE. It would. But then the public is very ungrateful.

Mr. OLIVER. It is not a question of gratitude. The doctrine of caveat emptor can very well apply in the purchase of a horse or a house; but in the case of transactions on the stock exchange, caveat emptor is not a fair rule; because the public can not investigate every single thing that goes on there. The stock may be that of a corporation which operates wholly in California; and on the stock exchange in New York, how can the average citizen that is buying that stock go out to California and look over the plant and examine the books of that corporation, and all that sort of thing? He is relying on these directors and officers of the corporation, and their representations that the company is doing a good business, and their stock is evaluated in the market. Is that not so?

Mr. LAWRENCE. That is so; and of course, all of those officers and directors should give the public information which will enable it to make a judgment.

Mr. OLIVER. Yes; and when they know that a stock is inflated to a tremendous value, is there not some duty in ethics and in common fairness on their part to prospective buyers of the stock to say to them, "Be careful, this stock has not that much value—"?

Mr. LAWRENCE. That is a matter of great peril to the business man who may do that.

Mr. OLIVER. It requires great courage and great honesty?

Mr. LAWRENCE. And then there is always the possibility that the man may be wrong.

Mr. OLIVER. Yes; but if he can prove that he is pretty nearly right—and he can prove it if he knows that the stock is earning only 2 per cent and it is selling at $250—he can not be challenged if he tells the public that he is of the opinion that they can not buy that stock at $250 and make anything out of it?

Mr. LAWRENCE. Yes, that is true; but you can not restrict the action of the public.

Mr. OLIVER. But you can try to restrict their actions. In other words, you are pointing out that the exchange is but the market place, and that the responsibility for prices rests somewhere else than in the market place; and it rests on the table tops of the executives of these great corporations?

Mr. LAWRENCE. I do not think I can subscribe to that absolutely. Of course, if you desire to have the public advised about the business—and the stock exchange does require by its rules that full publicity be given to all corporate issues and about the business of the corporation whose issues are traded in on the exchange, that is all right; but as to the interpretation of those facts the public must be left largely to itself. And I think where a man does step in and offer advice, he is like the proverbial mediator who steps in between the Irishman and his wife, and who gets the brickbats and not the bouquets.

Mr. MCKEON. I suggest that you proceed with your statement, Mr. Lawrence.

Mr. OLIVER. Yes; I am very much interested in your statement.

Mr. YATES. Yes; it is very interesting.

Mr. LAWRENCE. It is beside the point to say that a short seller by selling what he does not own depresses the value of the securities held by actual owners. The injury to these owners is just as great if the stocks are sold by those who have title to them. Perhaps they are too high. If the short seller is wrong, he pays for his error. On the other hand, every time a stock is purchased either outright or on margin everyone on the other side whether he has sold a stock he owns or one he has borrowed is adversely affected.

In other words, you have that play on both sides. If anybody sells a share of stock, it has, not a strong tendency, but some tendency to cause values to go down; because the man who sells the stock enters his judgment on the market place and says,

"I think this stock is not worth as much as I am getting for it; otherwise I would not sell it." And it does, in a theoretical sense, affect, therefore, the value of all the other holders of securities. And

at the same time, you have another influence on the other side of the market: Every time a margin trader steps in and buys a share of stock, or every time a bona fide purchaser steps in and buys a share of stock, there is a demand for that stock; and if you happen to have sold the stock short before that, the fact that others are buying that stock and sending it up adversely affects you. So that there are adverse influences resulting from judgments on both sides of the market; and you can not say that one of them is injurious because it happens to be on the short side and the other, on the upward side, is beneficial.

It can not be emphasized too strongly that no man can sell a stock short without the consent of the party from whom he borrows it. This owner either tacitly or explicitly permits the short seller, a market participant with an opinion of value opposed to his own, to sell his stock on condition that it be replaced at some later day. He knows full well that the borrowed stock will be sold and that it will have a proportionate effect on the market. No short sale is possible without the consent of a long holder. What difference is there between selling a stock which you own or lending it to another to be sold? How can we distinguish the effect on the market? Who is the agent of primary responsibility in this transaction, the man who borrows the stock or the man who lends it?

Now, we have been taking a mild vengeance, if you please—or, rather, we have been criticizing the short seller for taking stock which he does not own and tossing it into the market, thereby challenging the judgment of others who have bought. We seem to concentrate on the short seller, and seem to forget that that short seller can not sell stock without first securing the consent of the man from whom he borrows it, and the man from whom he borrows it knows full well that the man to whom he lends the stock is going to sell it, and it will have some effect on the market.

Mr. OLIVER. That change has only recently been made in the rules?

Mr. LAWRENCE. That recent amendment in the rules was not important, because the man has always had the right to say to his broker, "I subscribe to this, except that you can not lend stock that I am buying on margin." That has always been the rule. The trouble has come about due to the lack of knowledge of their rights by many buyers; and so recently the Stock Exchange has come out with a new rule, and it has redefined the rights of a holder of long stock. and placed the responsibility for lending long stock on the shoulders of the brokers.

Mr. OLIVER. For lending long stock?

Mr. LAWRENCE. For lending long stock.

Mr. CELLER. Well, heretofore there was a general authorization on the part of the margin trader that the stock could be loaned by his margin-trading broker?

Mr. LAWRENCE. That is right.

Mr. CELLER. But now they require a specific authorization in every instance?

Mr. LAWRENCE. Yes.

Mr. MCKEOWN. They go further than that. They even require the broker to notify the man at the time of the contract.

Mr. CELLER. That is right. There was heretofore a general authorization.

Mr. LAWRENCE. There was a general authorization at first, and at the time the man made his trade he could say to his broker, "You can not lend my stock on margin to anybody who wishes to sell it."

Mr. OLIVER. The trouble was that, in signing the customer's card, in making the agreement, the customers thought that the broker had the right to sell that stock to protect the broker's interest in it arising out of that transaction. But the broker then, by the mere power of loaning given in the customer's card, took the liberty of loaning it to another broker whose customer desired to bear down the price of the stock, as against his own customer's desire to see the stock go up; and it was that action, without the definite consent and understanding of the customer who was long, that led those customers into a practical revolution; because, while they were hoping to see it go up, their own broker, exercising not the duty of protecting the bargain between himself and his customer, but protecting some agreement between him and fellow brokers, loaned that stock to somebody that desired to use it for the purpose of bearing that stock down. And it was that that led many courts—and particularly Mr. Justice Black only the other day—may I put that decision in the record, Mr. Chairman? It is a magnificent decision. I would like permission to have that inserted in this record.

Mr. MCKEOWN. That may be inserted at the end of Mr. Lawrence's statement.

Mr. OLIVER. Yes; I would like for Justice Black's decision to go in, because it shows that those customers never dreamed that their stock was going to be loaned except for the purpose of protecting the account which the broker had with them; they thought that it was not going to be loaned for the purpose of bearing down the stock which they had bought for the purpose of seeing it go up. That is what led to this revolution among the customers.

Mr. CELLER. Would you say that it was a revolution among the customers?

Mr. MCKEOWN. We must conclude these hearings.

Mr. OLIVER. Let us stay here and finish them. We can hear Judge Sabath—I will stay here as long as necessary. I am very much interested. So that the time used by Mr. Lawrence will not be taken from the time of Judge Sabath.

Mr. CELLER. Will you answer that about the revolution, Mr. Lawrence?

Mr. OLIVER. Well, I will withdraw the word "revolution."

Mr. MCKEOWN. As I remember it, the impression has always been that this right to loan stock was in the broker's contract, and never was called to the attention of the customer; it was like those things they put into insurance policies, and so on.

Mr. LAWRENCE. That is correct.

Mr. MCKEOWN. All those provisions are just written in, and the man signs the contract without it being called to his attention, and he did not know it was in there, as a matter of fact; but he was bound by what he signed. But now the duty is on the broker to get the positive consent of his customer?

Mr. CELLER. That is right.

Mr. LAWRENCE. That is right. I think it is only fair to say that the brokers did not intend to deceive their customers, and that the customers exercised that right.

Mr. MCKEOWN. But the practice was to put it in and the man did not know, as a matter of fact, that it was in there?

Mr. LAWRENCE. That is correct.

Mr. MCKEOWN. And now the burden is on the broker to get specific consent of his customer?

Mr. LAWRENCE. That is correct; the burden has been placed on the broker; so that there can not be such a misunderstanding in the future.

Mr. MCKEOWN. You may proceed, Mr. Lawrence.

Mr. LAWRENCE. The shrewd and foresighted owner of stock will freely tolerate these judgments of value even though he disagrees with them. He knows from previous experience that his judgment is not infallible. It would be unwise to deny those who do not share his views a right to express their adverse opinions. They are a distinct market force. To shut them off by a narrow exercise of the right of ownership would be analagous to the well-known practice of the ostrich who hides his head in the sand in order to avoid disagreeable circumstances. The storm comes upon this bird suddenly. He has made no adjustment to meet it, established no defenses. That is exactly what happens in a market which permits no short selling. Changes are sudden and extreme. Because normal processes of anticipation have been denied, the consequences are catastrophic. It would be difficult to find evidence more conclusive on this point than our own experience with gold futures during the Civil War.

The imperative financial necessities of the Civil War compelled the Government to issue greenbacks in an amount which could not be maintained by available supplies of gold. A dollar is defined by laws as 23.22 grains of pure gold. As long as the Government is willing and able to support this value, 23.22 grains of gold and a dollar remain equal. The moment the Government confesses an inability to maintain this ratio the value of gold in terms of money rises. This is precisely what happened to the dollar in the latter part of 1861, even as it happened to the pound sterling on September 21, 1931.

Henceforth gold was bought and sold as any other commodity, both on a spot and future basis. The rise in the value of gold and the decline in the value of the greenbacks caused extreme annoyance to the Secretary of the Treasury and Congress. Congress had declared the new currency legal tender and made the age-old error of attempting to fix its value by legislative fiat. Consequently, the judgment of the market, clearly denying the ability of Congress to fix values, was provoking. Then, as now, a villain was sought, and he proved to be speculation, particularly the heinous practices of selling what was not owned. On June 17, 1864, Congress enacted a law which prohibited all speculation in gold, particularly the sale of gold which the seller could not deliver within 24 hours. When the law was enacted the price of $100 in gold was $198 in greenbacks. On July 1, two weeks after the law was passed, gold touched $285. On the following day Congress, realizing its error,

repealed the law. The denial of the market right to anticipate the future by speculative buying and selling had accentuated fluctuations and produced results the exact opposite of those intended.

The ability of short selling to reduce the range of price fluctuations and make such changes more gradual is demonstrated by a comparison of prices on the stock exchange and those of nonlisted securities. Standard Statistics Co. has compiled an index of 404 listed stock issues and another index of 20 New York bank and trust company stocks which are not listed. The latter have a wide market and are in every sense comparable to the listed stocks. The sole difference is that the bank stocks can not be sold short for speculative purposes with the same facility as a listed stock.

Let us consider now the range of fluctuations of these two groups:

We find that in 1929 the 404 stocks which could be sold short had an average weekly fluctuation of 13.23 per cent; whereas the 20 stocks which could not be sold short had an average weekly fluctuation of 24.82 per cent.

And so we find in 1930 that the 404 stocks which could be sold short had a weekly range of fluctuation of 5.75 per cent, and the 20 stocks which could not be sold short easily had a range of 10.57 per cent.

In 1931, the stocks which could be sold short had a range of 14.96 per cent, and the stocks that could not be sold short had a weekly range of 15.71 per cent.

In other words, the movement up and down on a fixed scale was greater in those stocks which could not be sold short and less in those which could be sold short, tending to prove that short selling reduced the range of fluctuation.

If we define intelligence as the ability to profit by experience and education as the capacity to prevent self-deception, then it is an act of intelligence and the mark tf an educated man to encourage and procedure which will facilitate the expression of realities. As the owner of steel stock which I have bought at $40 in the conviction that it is worth more, I am interested in having my judgment tested. Did I pay too much for it? The short seller can speed the issue. His offer of my stock will bring other buyers into the market. Will they pay as much as I paid? Will they pay more or less? It is to my interest to know what the consensus of judgment is regarding the value of my stock at this time.

The short seller adds to the volume of the market and offers an added challenge to values. If I fear the issue, I should not have made my investment in the first place, or having made it, and still fearful, I should retire to the woods and refuse to follow the market record. These two courses would at least have the merit of intellectual honesty. Instead of following either the opponents of short selling are now attempting to strangle adverse market judgments by legislation.

There are two ways in which the short sale is a definite aid to the long side of the market. Again, we take a hundred shares of United States Steel for illustration. The last price was $40. A market participant who thinks this too high sells a hundred shares, borrowed from another man who thought the price too low. The latter had bought a hundred shares on margin. He had deposited

$15 on each shares, and asked the broker to borrow the remaining $25. As these shares are sold short the broker receives $4,000 from another buyer and this, together with the $1,500 deposited as margin, by the short seller, enables him to finance the original owner.

In other words, assume that you have bought 100 shares of stock at $40, and you have deposited a margin of $15, and the broker has gone out and borrowed the other $25 for you. That involves a resort to the bank. It means that money must be brought from the outside. Now, I, as a short seller, step in, and your broker with your consent lends me the 100 shares, on which you have paid $15. You and he both know that I disagree with you on your judgment of the value of that stock. How are we to know whether I am right in my estimate of value? And so I take out the 100 shares of stock and sell them. Now, the broker says to me, "In order to do that you must deposit $1,500 as a margin;" he is speaking to me as a short seller. Therefore, as the result of my entrance into the market, the broker has $5,500 which he would not have if I had not stepped in. Now, that $5,500 is used to finance the purchase by you of 100 shares of stock.

Mr. CELLER. Which might make the price of the stock go up?

Mr. LAWRENCE. Yes; unfortunately for me—to the extent that you are a factor on the other side of the market, it has a tendency to send the price up.

Mr. OLIVER. And the short seller can not stay in unless he is able to put up more margin?

Mr. LAWRENCE. Yes, sir; in other words, he can not be a "kibitzer." If he steps in he must put his money down.

Mr. OLIVER. And he must put up more margin if the stock goes up?

Mr. LAWRENCE. Yes; he must do as everybody else does. He is not a gratuitous interloper.

Mr. CELLER. And he may have to pay a premium on the stock?

Mr. LAWRENCE. Yes; he may have to pay a premium. And if you count everything that is done, his possible loss, the payment of commissions, and everything else, it is probable that he must pay more for the error that he makes than you would if you bought 100 shares of stock.

Mr. OLIVER. Has there ever been a calculation made as to the amount of money made by short operations, as compared with the amount made by long operations? Do you make more money by short selling than by going long on the market?

Mr. CELLER. Mr. Whitney said that short sellers never die rich.

Mr. LAWRENCE. I can say that, in a great country like ours, with the benefit of the prosperity that we had for so many years, that a steady rise has been apparent in prices. The dice are loaded against the short seller. He is betting against the trend; and I am sure that, if it were possible to determine the gains made by short selling and the gains made on the long side of the market, there would not be any comparison, because the vast majority of them would be found to be on the long side.

Mr. MCKEOWN. The short seller seems to have come into his period of prosperity now, however?

Mr. LAWRENCE. The sun undeniably is shining on the short seller now.

Mr. OLIVER. And the pending tax bill might have an effect on the market?

Mr. LAWRENCE. That is possible, of course.

Now, then, there are two ways in which the short seller can help. He always creates an obligation to return to the market place for an equal amount of the stock. It is a mistake to assume that he creates a new supply. He takes a part of the existing supply, sells it and then undertakes to buy it back. If the addition to the supply is in any sense artificial, the addition to the demand in the form of repurchase is equally so. This accumulation of buying obligations on the short side was used effectively by the stock exchange to check a threatened runaway movement in prices after England announced the abandonment of the gold standard. The incident has been seized by critics of short selling. One group denies that the exchange authorities acted in good faith. It contends that short selling was suspended on this occasion to prevent the shorts from demoralizing the market, that the rush to cover forced prices upward, that the exchange again stepped in and removed the restriction on short sales in order to protect the short speculator. Consider the premises which this contention necessitates.

1. That the authorities of the New York Stock Exchange are dishonest and deliberately deceived the public in explaining their course of action.

2. That short selling could demoralize the market.

3. That the short interest exercises a dominant influence upon the New York Stock Exchange and can compel any course of action which will promote their interest and preserve them against the consequences of their own conduct.

The New York Stock Exchange is not infallible, and like every other human institution in an uncertain world makes mistakes. Every citizen is at liberty to question any conclusion which the exchange authorities derive from a given set of facts. He has the same right in examining the policies of the exchange. The charge of bad faith, entirely aside from its dubious fairness, argues a stupid incompetence on the part of the exchange to anticipate the consequences of deliberate public deception.

If short selling can demoralize the market no group will suffer more than the men who have the privilege of trading in that market. The value of that privilege depends entirely upon the maintenance of orderly conditions. The damage to the market structure and the injury to the trading privilege would far exceed any gains accruing from short selling. Here again the assumption argues an inability on the part of the exchange to appreciate its own best interests.

The premise of short dominance in the stock exchange and the dictation of exchange policies by bears is a strain upon normal credulity. Consider the fact that margin owners of stock, even in a bear market, outnumber the shorts more than 10 to 1, 10 bulls to every bear, even to-day; that a sharp and sustained decline in the market has a devastating effect upon commissions. The average man

interested in speculation can not see the short side. He is naturally a bull. If prices do go down, for whatever reasons, it has a tendency to reduce volume and cut commissions. If you own 100 shares of stock and you think that particular company is going on the rocks or going to have poor business, you sell that with a desire to get back your investment.

Mr. OLIVER. When the stock goes down 3 or 4 points lower on the whole market—some may go down 10.

Mr. LAWRENCE. That is right.

Mr. OLIVER. There are only a few shares along the line. Every time it goes down generally, it does not all get in the hands of the bear.

Mr. LAWRENCE. That is the rule.

Mr. OLIVER. It always gets into the hands of the bull if the entire market rises.

Mr. LAWRENCE. That is right.

Brokers, like most other human beings, are fundamentally optimistic and derive as little satisfaction from declining prices as the rest of us. Most brokers carry their own capital in the form of securities which suffer during a decline. Drastic recessions in security prices always invite popular criticism of the exchange and agitation for outside regulation. In the light of these obvious facts why should the exchange submit to exclusive guidance of the short interest? Were this even fractionally true it would terminate at once the usefulness of the security market and no group realizes this more acutely than the men who determine the conduct and policies of the New York Stock Exchange.

The character of the step which England took on September 20 unquestionably justified the exchange authorities in the assumption that it would release a flood of liquidation. The abandonment of the gold standard was tantamount to a repudiation of all English obligations payable in pounds sterling. It was a startling confession for a sovereign power to make in time of peace. However after the first reaction it was felt that the step might relieve England of a part of her debt burden, reduce domestic costs, make her a more formidable competitor in world trade, mitigate her unemployment problem, and on the whole show an immediate balance in favor of England. There was the further possibility of similar action by other nations, since realized, the general abandonment of the gold standard and a period of world-wide inflation in which the equities represented by common stocks would rise in market value. This started a counter buying movement in the presence of which the ban on short selling was no longer necessary. In fact it was sorely needed at this point to check an unwise exaggeration of the prospects. As soon as this became apparent the exchange authorities removed the restrictions on short selling.

Another group of critics argue that the ban on short selling being a prop in emergency should be maintained throughout as a constructive force in the market. This ignores the plain fact that a measure justified by an emergency may prove harmful under normal conditions. Uncle Sam operated the country's railroad system as a war measure. Few students in favor of it as an emergency measure are prepared to support permanent Government operation. A patient seriously ill is given oxygen as a last resort. Do physicians advocate this as a prop for the maintenance of normal health? The restriction of short selling on this occasion was an intelligent effort to use arbitrarily certain reserves of buying power in the market to check a threatened flood of liquidation. Were it used continuously it could never fulfill its emergency function.

Much capital has been made by critics of short selling and writers with a flair for the spectacular and the dramatic of the alleged "bear" raids and manipulation of prices by shorts. The charges betray a palpable ignorance of the power of economic forces and the futility of artificial attempts to control them. Consider some notable attempts at bull raiding which have taken place during the past year. On October 31, 1931, the Federal and State Governments of Brazil controlled directly and indirectly that country's total supply of coffee, 38,000,000 bags. This is roughly three times the average production of coffee in Brazil, and twice the total world consumption. What effect has this extraordinary artificial control had upon coffee prices? On February 3, 1931, Rio coffee in New York was quoted at 6¾ cents. A year later in February, 1932, the same coffee was quoted at 7 cents a pound, a rise of 3.7 per cent. In spite of an unprecedented control of supply with the full support of Federal and State Governments, with outside banking assistance aggregating $100,000,000 and the deliberate destruction of surplus coffee, the growers of Brazil were barely able to move the price of coffee in the face of a world insistent upon another level. On November 24, 1931, the chairman of the Federal Farm Board announced that the board was then holding 178,656,187 bushels of wheat, equal to 77.3 per cent of the total visible supply of 231,049,000 bushels. He also gave the total purchases of the board as 329,641,052 bushels equal to 37 per cent of the estimated crop of 892,271,000 bushels for 1931. What was the result of this epic effort to check the sweep of natural market forces? On February 3, 1931, the price of No. 2 red winter wheat at Chicago was 95 cents per bushel. On February 2, 1932, the same wheat was selling for 74⅝ cents, a decline of 21.5 per cent.

Under date of November 22 the Farm Board announced an agreement with southern bankers to continue withholding a total of 6,400,000 bales of cotton, the greater part of which has been held off the market throughout the past year. At the time this constituted 52.7 per cent of the total visible supply of domestic stocks amounting to 12,137,000 bales. How effective was this challenge to the power of the market? On February 2, 1931, the price of 1 pound of middling upland cotton at New York was 10.5 cents; on February 3, 1932, the price of the same cotton at the same place was 6.6 cents, a decline of 37.2 per cent.

These experiments were supported by every device and resource which the agencies of the growers, bankers, and governments could summon. They were free of legal restraints. The directing bodies were clothed with extraordinary powers. Yet the record demonstrates the dismal futility of the effort to halt the application of natural market forces. Nevertheless this overwhelming testimony has not prevented repeated charges that short interests can manipulate security prices and are a substantial cause of current distress.

Consider the statistical position of this short interest and contrast it with the foregoing examples. On February 1, 1932, the total short position on the New York Stock Exchange was 3,600,263 shares out of a total number of listed shares aggregating 1,319,232,336, equal to 0.00274 of the supply, or a little more than one-quarter of 1 per cent of the total. To this is ascribed greater power in manipulating the market price than 77.3 per cent of the total supply of wheat in the hands of the Farm Board, the 52.7 per cent of the visible supply of cotton, and practically complete control of coffee stocks by the Brazilian National Coffee Council. The ownership and manipulation of this one-quarter of 1 per cent of the total supply of securities is charged with a decline of approximately 50 per cent in the industrial production of the country from the high point of 1928 and a drop of 76.3 per cent in security prices. Alice in Wonderland in her most fantastic flights of fancy never conjured up such an inversion of logic.

The highly imaginative accounts of bear raids assume an iniquitous concurrence among short sellers. Obviously an isolated trader with a few thousand shares can hardly hope to drive the market down unaided.

Mr. OLIVER. The few thousand shares are always one particular stock. It might have a tendency to drag it down. Is that not the situation?

Mr. LAWRENCE. Of course, you have to assume first that the shares that are sold are a very substantial part of the total of that particular issue.

Mr. OLIVER. But when you talk of a couple of thousand shares, you are talking of one issue, not the entire market.

Mr. LAWRENCE. Very true; but this power is never at any time concentrated on one lot. It is spread over 30 or 35 or 40 or 50 different ones.

Mr. OLIVER. Do you not see the weakness of that proposition? If you do concentrate on two or three leaders and drag them down, then you drag down those that follow.

Mr. LAWRENCE. I say, sir, that first of all you must assume the amount involved is a very substantial part of the particular stock of which you are talking.

Mr. OLIVER. Yes; but a comparison of the entire output of the market is not exactly fair to those who contend that bear raiding on individual stocks have an effect on the entire market.

Mr. LAWRENCE. It is there, in this sense: The 1,300,000,000 shares of stock listed at the present time are in the hands of men who are potential buyers and potential sellers. Outside of those who own these stocks, there are millions of people who are ready to step in the market. If you have ever been in a brokerage house, you know that every customer's man in the house has a list of buyers and sellers. A man may have an order to buy 100 shares of General Electric, if it drops down to 20. It may at the time be 21. He is not willing to pay 21, but he thinks 20 is a good price. In most instances that order is multiplied by many others. It is quite impossible to say how many there are, but we know there are millions of orders of that kind. As soon as the price drops down it immediately brings a flood of potential buyers into the market. The same

is true on the other side. As prices go up, a good many of those who hold stocks will think the stocks are overvalued. You can not compare the total number of shares of stock sold on the market with the number sold short, because you will continue to find others on the edge of the market who have not actually signfied their intention to buy, but who are potential buyers or potential sellers, as the case may be. I think, on the whole, it is probably a fair position to take the short interest and compare it with the total amount listed.

It is necessary, to be effective, to have fellow conspirators. Consider the difficulty of achieving effective concerted action which will endow one-quarter of 1 per cent of the outstanding supply of a commodity with the power to precipitate prices to lower levels. First, we have the difficulty of numbers. On September 21 the total short interest of 3,697,000 shares was held for 9,369 accounts. On November 24 the total short interest of 3,584,610 shares was held for 12,254 accounts. It is absurd to suppose that agreement could be effected among a sufficient number of these accounts to bring about concerted action.

In the second place, the stock exchange authorities are firmly opposed to market interference of any character which is demoralizing or interferes with the free and natural expression of market judgments. The authorities have vigorously investigated all charges of deliberate raiding.

Mr. LAGUARDIA. What authorities?

Mr. LAWRENCE. The stock exchange authorities.

In spite of their constant presence on the scene, their familiarity with the conditions of the market and the power which they have over members, they have not been successful in detecting a single instance of these highly publicized raids upon the market. Understand, they may take place, but I want to emphasize the fact that the stock exchange authorities are just as much if not more interested than any other constituted authority in discovering these conspiracies among short sellers to artificially change prices.

Mr. LAGUARDIA. Would it be impossible for these authorities to be concerned in it?

Mr. LAWRENCE. To participate in such an act?

Mr. LAGUARDIA. Yes.

Mr. LAWRENCE. I would not say it would be impossible; no.

Mr. CELLER. As far as investigations have disclosed, there has been no participation by members of the stock exchange in such acts?

Mr. LAWRENCE. No.

The authorities are severe and uncompromising in the application of penalties to any member who violates its rules. The discovery of participation by a member in a deliberate and concerted attempt to depress security prices would cause his expulsion from the stock market, a penalty from which there is no appeal and for which there is no commutation.

There has been altogether too much of a tendency to speak of the short seller as a particular and distinct species of market trader. The discussion assumes that a group of speculators have taken a short position on the market as a whole and maliciously sold the entire United States short throughout this period of declining business and security prices. I know of no trader who has taken such

a position. I have discussed the matter at length with many men and women who make a livilihood in the stock market. It has been impossible to discover a single sinister and consistently saturnine short seller. The short seller invariably exercises meticulous discrination in his commitments. His position is based not upon the hypothesis that the entire country is in a permanent state of decadence but rather that the particular companies have a future which has not been adequately discounted in the prices of their securities.

This same short trader may be long in other stocks at the same time. The short seller and the long buyer, in other words, are often the same person although short and long positions will be held in different stocks. A particular trader may be predominantly bearish or bullish at any given moment. Rarely do we find a speculator unequivocally and completely bearish or bullish. He is constantly exercising the prerogatives of intelligence and is attempting to anticipate the probable. He is seeking to make an early personal adjustment to the future. To this end he studies conditions carefully and makes his decision.

The short seller has been criticized in current literature as well as in some of the opposing testimony for his lack of altruism. It is alleged that he experiences no sense of responsibility for the stability of the market and is actuated by no loftier motive than the desire for profit. It seems a trifle strange that a man or woman pursuing a legitimate livelihood, assuming great risks and exercising painstaking judgment, in an occupation whose legality and social value have been repeatedly recognized by the highest authorities, should be condemned for acknowledging the acquisitive motive.

This criticism could be comprehended in Russia where the ambition to make a profit and accumulate worldly substance is under fanatical taboo. Why such a position should be entertained in a society where individual initiative is still granted a measure of free play is not clear. Particularly difficult is it to understand such a position when assumed by a corporation lawyer, an investment counselor, a professional writer or a business man. There is a general suspicion that no one of these classes labors for the love of service alone. It is possible that each one might in an unguarded moment admit the unholy aspiration of personal gain. Why ask the short seller, who uses his wits and pledges his credit and legal tender upon the soundness of his judgment to be burdened with magnificent social responsibilities which none of his critics have been known to embrace?

Although it is difficult to see how ethical considerations are in any way involved in a free market judgment accompanied by every normal risk, much has been made of the ethical indefensibility of selling a stock not owned at the time of sale by the seller. Selling a borrowed stock is in every respect on a par with the purchase of a stock or anything else with borrowed money. The short borrows his stock and sells it with the conviction that the stock should be worth less and money more.

He realizes what few of his critics appreciate, that a sale is an exchange and that it is just as logical to think of money being sold as it is to think of a stock being sold. When he offers a share of stock for $40 he is buying $40 because he considers money in terms of

the stock undervalued and believes that it will rise. He is a bull on money and a bear on stock. If he can subsequently exchange $35 for a share of stock, his position will have been justified. The bear sells a stock short and buys money long. The bull sells money short and buys a stock long. The bull is convinced that money is overvalued. The bear believes it undervalued. The bull sells the money which he does not own; the bear sells the stock which he does not own. If the short injures the equity of those who own stocks, then the bull just as certainly injures the equity of everyone with a bank account or cash in his pocket. In so far as deliberate intent plays any part in the process the short seller is trying to depress the value of stocks and the long buyer is trying to depress the value of money. Speculators on both sides of the market, however, are too intelligent to try to deflect the direction of basic economic movements by their own conduct.

Finally, a word must be said regarding the motives of the stock exchange in defending short selling. It has been charged that the exchange authorities are defending the practice for no other reason than the desire to earn the commission which a short sale makes possible. This attributes a degree of stupidity and blindness to its own interests which scarcely flatters the exchange. If short selling is in any way a contributing cause of our current distress, then the exchange is the worst sufferer from its own malfeasance.

EXHIBIT THREE

ACTIVITY IN PRODUCTION, DISTRIBUTION AND FINANCE

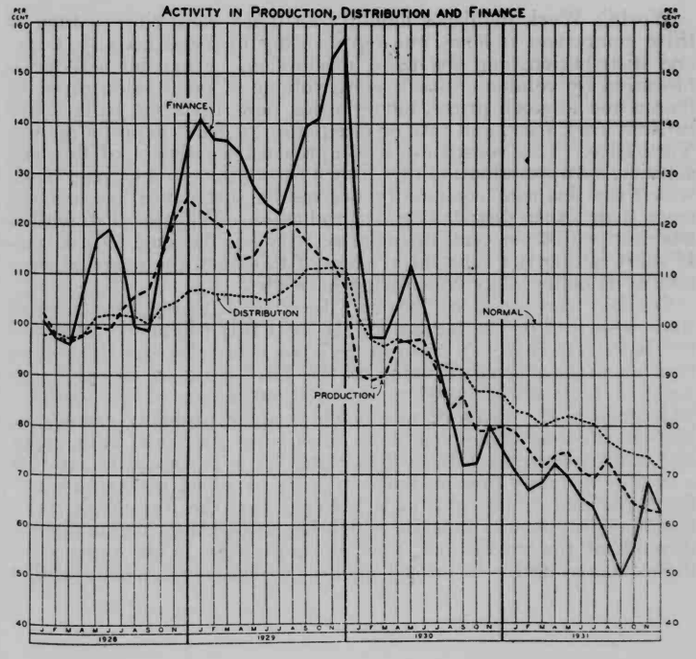


EXHIBIT 3

Indices of business activity

[World's Work]

	Financial activity	Production	Distribution		Financial activity	Production	Distribution
1928	*Per cent*	*Per cent*	*Per cent*	1930	*Per cent*	*Per cent*	*Per cent*
January	100.8	102.4	97.9	January	116.8	90.3	101.5
February	97.4	97.8	98.4	February	97.7	89.2	97.2
March	96.4	96.5	97.5	March	97.6	90.0	95.8
April	106.8	97.9	98.0	April	104.0	96.8	97.4
May	117.2	99.5	101.5	May	112.0	97.0	96.5
June	119.3	99.1	102.0	June	104.2	97.2	94.7
July	113.0	103.2	102.0	July	94.1	91.2	92.6
August	99.7	105.9	101.7	August	84.0	83.2	91.5
September	98.9	107.1	100.2	September	72.1	86.0	91.2
October	113.9	114.1	103.4	October	72.5	79.2	87.2
November	123.1	120.8	104.6	November	80.4	79.2	87.2
December	136.8	125.4	106.8	December	75.5	80.1	86.6
1929				1931			
January	141.0	122.7	107.2	January	70.9	78.8	83.2
February	137.2	120.7	106.3	February	67.0	75.5	82.5
March	136.8	119.2	106.3	March	68.5	71.8	80.3
April	134.5	113.0	105.8	April	72.6	74.1	81.2
May	128.0	113.8	105.8	May	69.8	74.9	82.0
June	124.4	118.7	105.0	June	65.5	71.0	81.2
July	122.3	119.3	106.1	July	63.7	69.4	80.5
August	131.0	120.6	108.1	August	57.2	73.5	77.2
September	139.6	116.8	111.1	September	50.4	68.7	75.4
October	141.0	114.0	111.2	October	55.6	64.4	74.5
November	153.0	112.9	111.5	November	68.8	63.3	74.0
December	157.2	107.4	111.3	December	63.0	62.9	71.4

World's Work publishes monthly an index consisting in turn of three component indexes, one representing financial activity, a second distribution, and the third production. Financial activity is measured by volume of stock sales, volume of bond sales, range of fluctuation in stock prices, money rates, new financing, bank debits in New York City, and rate of circulation of bank deposits in New York City. This constitutes a comprehensive measure of financial activity. An examination of Chart 3 shows that this activity from which the financial community derives its sustenance has suffered more than either distribution or production. Whereas distribution has dropped 26 per cent, financial activity has declined 60 per cent. If short selling is a substantial cause of this, then the financial community is deliberately committing hara kiri.

Consider the factor of income. In 1929, 1,124,990,980 shares of stock were sold on the big board. In 1931 this volume had declined to 576,921,426 shares, a drop of 48.7 per cent. During these same two years the aggregate value of the 1,375 seats on the exchange declined from $679,250,000 to $196,930,250, a loss of $482,319,750. This drop in the value of memberships alone probably exceeds all the commissions earned on short sales since the New York Stock Exchange was first established in 1792. It is as logical to say that a man deliberately fires his home in order to collect insurance covering 5 per cent of its value as it is to say that the New York Stock Exchange supports a practice which has caused inestimable distress throughout the world—but, nowhere more than in the purlieus of the exchange itself—in order to collect added commissions. Either

short selling is not a cause in any degree of the present depression or the stock exchange is deliberately inviting stupendous losses. The conclusion is inescapable that the exchange is at least honest in its conviction that short selling is necessary to a free and orderly market. The vulnerability of the financial community to losses during depression makes it equally clear that short selling in its own honest judgment can not be a contributing cause of our current afflictions.

There is little in the past conduct of the stock exchange to indicate a subordination of public duty to private profit. No group of men on earth understand and appreciate the value of a free, open market as do these men. They have repeatedly abjured opportunities for handsome profits in order to maintain the integrity of the world's greatest security exchange. No market on earth is so exacting in its listing requirements as the New York Stock Exchange. It can not certify values because the very nature of value makes such a fixation impossible. It does insist upon the maximum amount of informative and accurate facts regarding enterprises whose securities are admitted for trading.

It was the insistence of the New York Stock Exchange upon the fullest publicity which resulted in the organization of the curb market. Had the New York Stock Exchange then been more lax in this respect, it could have obtained all that business for its members. It held to certain high standards and, as a result, companies which refused to meet those standards got together and established the curb market.

Had the authorities been interested in profits alone, they could easily have relaxed their requirements. Again throughout 1928 and 1929, when investment trusts were the speculative favorites, the stock exchange might have enriched its members by permitting the ready listing of this type of security. In practically every stock market in Europe "puts" and "calls" are freely admitted as a normal part of the speculative market practice. Here again the stock exchange has traveled the second mile with the public and denied this highly speculative and equally lucrative practice to its members. Its restrictions upon advertising by members is another check upon volume of business and profits, the results of an uncomprising desire to maintain the highest possible standards for its members. These facts are all well known to the critics of short selling. Nevertheless they blithely leap to the conclusion that short selling is tolerated by the exchange in clear contravention of public interest for no other reason than to line the pockets of its members with added pelf.

Mr. OLIVER. I would like to put in the record a decision by Justice Black of the Supreme Court of the State of New York, entitled Jines et al. versus De Ronde. It appeared in the Law Journal of New York State on February 25, 1932.

Mr. LAGUARDIA. Mr. Chairman, I am very glad my colleague from New York has put this decision in the record. It is not only a scholarly decision, but gives the activities and practices of the New York Stock Exchange in a most accurate and fascinating manner.

(The decision referred to is as follows:)

SUPREME COURT—TRIAL TERM, PART IV

(By Mr. Justice Black)

Jones et al. *v.* De Ronde. Plaintiffs in this case, who are members of the New York Stock Exchange, sued defendant for $17,951.44, balance on a customer's account, and also claimed that there was an "account stated" as between the plaintiffs and the defendant by reason of the fact that an account had been mailed defendant, which he had accepted and retained without objection. Upon this account at the bottom were the words: "It is agreed that all securities purchased or sold on margin or deposited in this account may be pledged by us with other securities or otherwise used in accordance with the customs of members of New York or Philadelphia Stock Exchanges, and that on default as to margin, we may buy or sell said securities without notice of time and place of sale. Please examine this statement at once, reporting promptly any discrepancy that may appear therein. If a report is not received within 10 days, the account will be considered correct." Plaintiffs also sought to sustain their contention by a printed agreement signed by the customer which will be referred to later. This agreement was headed in big type "Customer's signature card." The body of the agreement is in nonpareil, 6-point type. A copy of it is attached at the end hereof. Defendant denies that anything is due plaintiffs and claims that he repeatedly protested to plaintiffs as to the correctness and accuracy of the statements that plaintiffs had sent him, and denied plaintiffs' athority to make some of the trades the account showed. The "Customer's signature card" offered in evidence was signed by the defendant, who is being sued for the balance, and "accepted by" the plaintiffs by three letters written in lead pencil on the left side at the bottom. This "customer's signature card," within its printed dimensions of 8 by 5 inches (from which must be deducted the 1⅞ by 1 inch for margin and signatures) contained 455 words, and it will be observed that after the reassuring expression that "stocks and securities are pledged to the broker as collateral security" it provides "that such stocks, securities, and commodities may be loaned by the brokers" (this means that stocks bought by the signer of the card could be loaned by the broker for "short sale" deliveries in which the plaintiffs had no interest, but which could have only the effect of "bearing" the stocks covered by plaintiffs' purchases), "or may be pledged, either separately or with other securities, for any amount, and commodities carried by the broker for the customer's account, or supplied by them against sales by the customer, may be sold or purchased at brokers board, or at public and private sale, without notice of such sale or purchase deemed necessary" (presumably in the opinion of the broker) "for the broker's protection; that brokers may in said purchases or sales act as principal if they so desire; that in the event of such sales or purchases being insufficient to liquidate the account, the customer agrees to pay the balance due upon demand." It will be observed that in the first paragraph of this "customer's signature card" the customer says: "I desire to arrange with you to act as brokers for me," and that the expression in the second paragraph above quoted is that the brokers may in said purchases or sales act as principal if they so desire. We thus find that in the same contract the customer states his desire that the plaintiffs (the brokerage firm) act as his broker and that the brokers exact the agreement that they may act as "principals, if they so desire." This may mean that the broker may act as principal in dealing with outsiders, but by no flight of legal fancy could they act as principals to their customer who had in the first line of the agreement expressed his desire that the brokerage firm should act as his "broker." It is difficult to conceive of a more one-sided agreement, or one more unfair. To hold that it bound defendant would be to assume that the defendant understood all the whole technical and intricate workings of the stock exchange and its Stock Clearing Corporation, and all the customs of the exchange or market where the transactions are executed, and the court would also have to assume that the defendant (the customer) knew all the amendments to the rules or by-laws governing the New York Stock Exchange and its clearing house. The constitution of the New York Stock Exchange comprises 49 pages in The Law of Stock Brokers and Stock Exchanges (Meyer), containing 26 articles and 124 sections, some of which sections have 20 subdivisions.

The rules of the stock exchange cover 34 pages, 22 chapters, 125 sections, and 29 subdivisions. Stock-exchange rules relating to the delivery of securities cover

10 pages, with 264 sections. By-laws of the Stock Clearing Corporation consist of 13 articles, 39 sections, and 11 subdivisions, covering 12 pages. Rules of the Stock Clearing Corporation cover 41 pages, with 41 rules and 35 subdivisions. Of course, most of these voluminous provisions do not apply to the present case. The defendant testified that he was not very familiar with the transactions between the broker and his customer, although this was denied by plaintiffs. If the court should give the effect to the contentions which plaintiffs' attorneys contended for, it would mean that if a customer agreed to be bound by a statement of account by a broker, and did not object within 10 days, that he could not afterwards be heard to say what the truth was about the account, even though, as occurred in this case, there were errors which the plaintiff itself, subsequent to the rendition of the first accounts, discovered and corrected, and if this court should hold that the broker had the unlimited and all-embracing powers covered by the contract contained in the customer's signature card, the broker would have the right to lend stocks (bought by the customer for a rise) to himself or others for the purpose of making deliveries under so-called short sales. The effect of such a ruling would be that a broker holding such a monstrous contract as that contained in the customer's signature card could take the very stocks the customer had bought with the expectation and hope of a rise and deliver them to another customer of their own or of some other broker, so that such other customer of their own or of another broker could under the rules of the exchange use these very shares to hammer down the price not only of those shares themselves, but of the entire list of shares dealt with on the exchange. Because holders of the same shares as those bought by the customer must protect their accounts when called for margins by cash deposits realized from the sale of any other shares they may own. No one who has the least knowledge of the market would ever believe that a customer who signed a customer's signature card ever had any such intention. If the intention of the plaintiffs had been to apprise the customer of the effect of what he was signing, they could have specially set out in the customer's signature card, signed by the customer, that the broker was authorized to use the stocks which he had purchased for defendant to make deliveries under short sales. This was done in the contract in the case of Klapp *v.* Bache (229 App. Div. 415). Then the broker only had the right under his contract to use the customer's stocks in this manner if there was a failure on the part of the customer to comply with the provisions in the agreement in the customer's signature card. In the present case there is no such limitation. It would serve no useful purpose to characterize this vicious customer's signature card. It can be compared to nothing except a commercial "dead fall." The only comparison that suggests itself to this contract on the customer's signature card is to say that it is in the nature of a self-starting financial guillotine prepared by the plaintiff for the customer. Of course it is conceivable that a plaintiff might never take advantage of such drastic and unconscionable provisions, but the potential effects of this customer's signature card are beyond calculation in the damage that might be done the customer who signed it if the broker saw fit to invoke it and the courts should enforce it. It is totally one-sided for the benefit of the broker. It lacks consideration, because for this entire parting with his rights the customer secures no correlative advantage. It seeks in its close fine print to entirely repeal the law of the State of New York first set forth in the case of Markham *v.* Jaudon (41 N. Y., 235), where it was clearly held that the relation of the customer and the broker is that of pledgor and pledgee, and that the broker, from the time the order is given, is acting for the customer, and that he has no right to sell out a customer without reasonable notice that further margins are necessary, so that the customer may have the right to furnish them in order to protect his trades. For his work for a customer the broker is paid a commission, and upon the difference he advances between the margins put up by the customer and the value of the stock, he is paid interest, presumably no lower interest than he pays for the money borrowed for the customer's benefit. He has no right whatever, especially in the absence of any failure on the part of the customer to carry out his agreements, to lend stocks bought for a rise in the market to other accounts or to other brokers for the purpose of making deliveries under short sales where the only tendency can be, at least temporarily, to depress the market and to that extent destroy the value of the customer's stock which he has innocently bought for a rise in the market.

There is no evidence that this agreement was dictated or has been approved by the New York Stock Exchange or its stock clearing corporation, but the agree-

ment by express terms attempts to use the prestige of the stock exchange and its stock clearing corporation by providing that all transactions are subject to their rules. To enforce this fantastic agreement against defendant would be tantamount to holding that the "customer's signature card" signed by a layman, in fine print, giving the most universal powers that could be framed for any attorney in fact, could be invoked to preclude defendant from showing the actual state of his account, once any statement, however inaccurate, had been mailed to him and remained accepted by him, without objection for 10 days. Such an agreement, secured in such a manner, violates every principle of public policy, and consequently I hold that the plaintiffs have not made an account stated merely by putting in evidence the account with the agreements attached to it and by putting in evidence the contract that has been referred to. The learned counsel for the plaintiffs in this case quotes an able writer on the law of stock brokers and stock exchanges to the effect that "it is customary for brokers on opening a margin account to require the customer to sign a written agreement defining the conditions on which the account will be carried. * * * A special agreement is therefore essential to give him the rights which the legitimate needs of his business demand, but which, in the absence of the customer's consent, have been denied by law. Special agreements between broker and customer granting these rights are valid and will be enforced in accordance with their terms." The cases quoted in plaintiffs' memorandum, however, do not sustain this position. And whether "special agreements between broker and customer are valid and will be enforced" depends entirely on what those special agreements are. In the case of Byrne *v.* Weidenfeld (113 App. Div., 451, 453) the decision turned on the point that in an action to recover the value of securities alleged to have been converted, which were pledged with the defendant, where the defendant answered that the securities had been pledged pursuant to an agreement of joint venture with the consent of the plaintiff, it was error to exclude evidence of such joint venture, etc. It was upon that error that the judgment for the plaintiffs was reversed. The court says at page 454: "The exclusion (of the evidence regarding the joint venture) requires a reversal of the judgment." The court says on page 452: "The principal question on this appeal is presented by the ruling in exclusion of testimony offered to establish a defense" (that there was a joint venture). The case of Smith *v.* Craig (211 N. Y., 456), quoted to sustain the proposition that there is no necessity under a written agreement for demanding margin, was one where a plaintiff sued for damages because the broker had sold him out. But in that case the broker had "endeavored to reach the plaintiff at his hotel here (presumably New York) and also in Boston, for instruction * * * but was unable to do so. * * * Plaintiff admitted that he received these several statements, but asserts he did not read them except to look at the price for which the cotton was bought or sold." The court merely held that the statements connected with these transactions should have been received in evidence, and it should have been left to the jury to determine whether the plaintiff had agreed with the defendants that in case his margins were running out they could sell his contract without notice to him of the time and place of such sale. Milliken *v.* Dehon (27 N. Y., 364) is quoted in plaintiffs' memorandum as authority for the statement that agreements have been upheld where they permitted a private sale in lieu of a public sale, but there the court held, that the "consignee" is bound to give notice of a decline and make an actual demand for the margin. Such demand need not be personal, but may be made of the consignor's clerk employed by him as his agent in a particular transaction. The case quoted in plaintiffs' memorandum to the effect that special agreements are not contrary to public policy: Baker *v.* Drake (66 N. Y., 518) merely holds that the parties to a contract may provide therein for any manner of disposition of the pledge to satisfy a claim upon it, which is not in contravention of the statute, against public policy or fraudulent.

The court at page 522 says: "All but two (Allen and Rapallo, JJ.) of the members of the court adhere to the decision in Markham *v.* Jaudon (41 N. Y. 235) on three points there maintained: First, that the relation of broker and customer in the ordinary contract for speculative purchase of stocks is of pledgee and pledger; second, that the sale of the stock by the broker under such a contract, without notice to the customer of the time and place of sale, is a conversion; third, that oral proof of the usage of brokers in such cases is not admissible to add to or to make part of the contract." I do not think that the reasoning in Godfrey *v.* Newman et al. (135 Misc. 764) quoted in plaintiffs' memorandum, which came up in the municipal court, is applicable in this case. The case quoted by plaintiffs of Keller *v.* Halsey (202 N. Y. 588)

to sustain the position that a contract may arise as a result of the brokers sending notices to the client, on which appears a statement setting forth the terms and conditions under which he is transacting the client's business, merely held that it was a question for the jury as to whether the offer of the broker contained in the printed statement had been accepted by the client so as to constitute a contract. The plaintiff sued brokers for wrongful and unauthorized sale of his stocks. There a judgment for the defendants was directed by the court. Notwithstanding the fact that the defendants had promptly rendered the plaintiff an account of the transaction to which he had not only made no objection, but, on the other hand, ratified and confirmed, the court said that this judgment directed by the court in favor of the defendant should be reversed and a new trial granted. The court said the plaintiff had the "legal right to have the jury pass upon his credibility as a witness, and hence the direction of a verdict was an error of law that calls for a new trial." The case of Thompson *v.* Baily (220 N. Y. 471) is quoted under the same point by the plaintiff, and although there was a confirmation of the sale on a printed form which stated the execution of the order and noted as follows: "It is further understood that on all marginal business the right is reserved to close transactions at our discretion without further notice when margins are running out," the court said that the jury could find that the later order was given in the belief that the defendants would assume the usual duty of a broker to close the transaction upon notice. Hence the nonsuit was erroneously granted and the court reversed the granting of a nonsuit and ordered a new trial. From the opinion of the court, written by Mr. Justice Cardozo, I quote the following (p. 475): "The defendants say that the plaintiff must be held as a matter of law to have agreed that his cotton might be sold without notice whenever margins were running out. We do not share that view. In the absence of agreement to the contrary a purchase upon margin charges a broker with the duty to carry the thing purchased for his customer until additional margin has been demanded and refused. * * * If some other agreement was made, the defendants have the burden of proving it. They claim to have proved it in two ways—first, by the notice which they gave the plaintiff after they filled his order in December, and again by the notice which they gave him after they had bought the cotton in controversy. Whether the effect of these notices was to make out a new contract was a question for the jury. The plaintiff's assent is not so clearly proved as to make a question for the court. The previous transaction, standing by itself, did not prove a course of dealing. It did not prove, as a matter of law, that later transactions would be subject to the terms stated in the notice of confirmation (Smith *v.* Craig, 211 N. Y. 456, 464). It left the terms equivocal, for the notice of the reservation of a right to sell at discretion may have been nullified in the plaintiff's mind by the statement of defendant's agent that margin would be asked for if required. The perfunctory warnings of a printed blank express at the utmost the defendants' general practice.

They will readily yield to other and more specific statements of the practice to be followed in dealings with a particular customer (Clark *v.* Woodruff, 83 N. Y. 518, 523). The lines of the contract are not so sharply defined that the court is free to trace them unaided by a jury. The defendants did not ask the plaintiff in so many words to assent to their reservation of extraordinary powers. They left his assent to be inferred from his receipt of printed forms, which belied the assurance already given by their agents. The quotation by the plaintiff from the case of Smith *v.* Craig (211 N. Y. 456) on page 11 of his brief refers to an agreement to close transactions without further notice, and to settle contracts in accordance with the rules and customs of the New York Cotton Exchange, but in that particular case the defendants had endeavored to reach the plaintiff at his hotel, and it will be observed that the agreement referred to "further notice," evidently meaning that some notice must be given before the sale. Further on in the opinion, at page 464, the court says: "The statements with the printed notices thereon received by the plaintiff after each purchase and sale did not conclusively establish a contract between the plaintiff and defendants in their marginal dealings in cotton, but they were evidence to be considered in connection with the testimony of the plaintiff." In the case of Klapp *v.* Bache (229 A. D. 415), quoted by plaintiff, the contract is different from that relied on to bind defendant in this case. The contract in that case, which received the approval of the appellate division, and afterwards affirmed in 225 N. Y., without opinion, had no statement at the top in large type that it was a customer's signature card, and it provided that the broker "upon failure of the undersigned to comply with any of the pro-

visions thereof was authorized to sell," etc., whereas the customers signature card in this case provided: "That all stocks, securities, and commodities from time to time carried in the customer's marginal account or deposited to protect the same are pledged to the brokers as collateral security for the general indebtedness of the customer to the brokers; that such stocks, securities, and commodities may be loaned by the brokers or may be pledged by them, either separately or together with other securities, for any amount; that all stocks, securities, and commodities carried by the brokers for the customer's account, or supplied by them against sales by the customer, may be sold or purchased at brokers' board, or at public or private sale, without notice, if such sale or purchase be deemed necessary for the broker's protection.

"That brokers may in said purchases or sales act as principal if they so desire. That in the event of such sales or purchases being insufficient to liquidate the account, the customer agrees to pay the balance due upon demand." All that the case of In re Toole (274 Fed. 337) holds is that in the absence of an agreement that they will not do so, stockbrokers have a right to repledge collateral deposited with them to secure advances on margin transactions. The case of Wicks *v.* Hatch et al. (62 N. Y. 535) merely held that under an agreement a broker might sell when the margin fell below 5 per cent. The case of Manning *v.* Heidelbach (153 A. D. 791) simply held that if the notes were not paid broker had the right to sell the collateral without notice. Douglas *v.* Carpenter (17 A. D. 329) is authority for the proposition that a broker can only borrow on securities up to the amount of the customer's indebtedness. In Sproul *v.* Sloan (241 Penn. State 284) it was held that the fact that a customer suffered no actual damage by the broker's conversion of the stock was immaterial; that the fact that such hypothecation was a common usage can never be shown if it be in contravention of a well-established rule of law. But there is other evidence in the case which in my opinion entitles plaintiffs to a verdict: First, because the customer, after notice of what had occurred, drew considerable sums from his account; second, because on one occasion he requested the reinstatement of his account, after notice of everything that had occurred, which request was acceded to by plaintiffs; third, he wrote them that he "expected to be able to hand you (the plaintiffs) some cash to put his (defendant's) house in order." Indeed, he put up additional collateral to secure his account after he had been notified of what had transpired. These acts on his part constitute a ratification of what he had been notified of. Certain stocks which had been sold out, as plaintiffs claim, by the authority of the defendant, were repurchased for defendant's account after all the alleged transactions had been completed. The court required strict proof by the plaintiff that the purchases and sales were actually made through the stock exchange, which proof plaintiffs furnished in detail. Defendant was unable to convince the court that the plaintiffs had acted in bad faith in the handling of his accounts. For all these reasons, and regardless of plaintiffs, failure to make out an "account stated" against defendant, judgment is directed for the plaintiffs against the defendant in the sum of $17,951.44, principal, and $2,076.21, interest to January 25, 1932. Defendant's motion to dismiss the complaint is denied. Appropriate exceptions to defendant. Thirty days' stay and 60 days to make a case.

STATEMENT OF HON. LUTHER A. JOHNSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. McKeown. Representative Johnson of Texas has a statement he desires to make.

Mr. Johnson. Mr. Chairman and gentlemen, I will only take a moment. I am here to present for the record a telegram from Fortson Bros., a firm in my home town of Corsicana. They are men of affairs, farmers on a large scale, bankers and business men, men who have had dealings not only in agriculture, but stocks and bonds, and men whose judgment, therefore, is of value, because of their experience. I will read their message to me:

CORSICANA, TEX.

LUTHER A. JOHNSON,
House of Congress, Washington, D. C.

We believe short selling on stock exchange is the principal cause of depreciation in all values and has been carried to such extremes that it has demoralized the people, and all values. Short selling is the most destructive agency existing, and the bills passed and all efforts of Congress will be a failure unless it is abolished. To sell millions of shares that never existed is a thousand times worse than old Doctor Cook, who is now serving 14 years in the penitentiary. We urge your consideration before the committee to the end that this practice may be abolished.

FORTSON BROS.

STATEMENT OF HON. WILLIAM V. GREGORY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KENTUCKY

Mr. McKeown. Representative Gregory desires to present something to the committee.

Mr. Gregory. Mr. Chairman, I desire to present a brief statement from parties in my section of Kentucky who are interested in this subject. The president of this company desires to appear before the committee and discuss short selling from a different angle than has been presented heretofore, namely, that it is oftentimes used as an effective instrument in private competition in the utility business. He has prepared a brief statement which I would like to submit to the committee.

Mr. McKeown. It may be incorporated in the record.

(The statement referred to is as follows:)

MARCH 4, 1932.

Gentlemen of the committee, in appearing before this subcommittee, it is my hope that either the House or Senate in its investigation of short selling will pursue a line of inquiry that thus far seems to have been entirely overlooked.

It occurs to me that in your hearings to date the short seller or bear raider in securities has been considered solely as an individual who seeks to profit in a monetary way by such forced liquidation of stocks as would enable him to cover his short sales at a lower price.

I would like, however, to discuss another type of bear raid on listed stocks—that type of raid which is engineered for the express purpose of destroying competition by bankrupting a rival company whose expansion program must be financed through the distribution of its common stock.

While the sponsors of such a bear raid usually are difficult to identify, I feel that appropriate legislation is necessary to prohibit the communication of false information with respect to securities in certain cases, as proposed by Congressman Sabath. I also am of the opinion that Congress should enact some measure prohibiting the suggesting or advising of short sales in a concerted raid against securities.

The disclosures I am making before this subcommittee have never been a matter of public knowledge. They are made, furthermore, with considerable reluctance, but I feel that the obligations to my stockholders, and to the public generally, will no longer permit hesitancy on my part.

I trust that the story of my company's experience with bear raiders will impress upon the committee the need for strong protection against particularly that type of bear raiding which is committed in direct defiance of the Sherman Antitrust Act.

In May, 1930, the Missouri-Kansas Pipe Line Co., of which I am the president, began the construction of a 1,200-mile natural gas pipe line system, starting in the Texas Panhandle and with an intended terminus in Indiana. The construction was started only after the feasibility of our program had been thoroughly supported by independent engineering estimates, and it was our plan to finance the project practically in its entirety through the sale of common stock.

The general practice of financing an enterprise of such nature is principally through the sale of bonds. My judgment, however, told me that since this was a construction enterprise it would be much safer to finance it through the sale of common stock than to burden it with fixed charges for capital expenditures during the period of construction and preliminary development.

Accordingly, I organized a separate company for the distribution of this common stock, in order that the financing might be carried forward as economically

as possible, and we began at once through our investment dealers to make exceedingly rapid headway.

On June 14, about three weeks after construction on the pipe line from Texas was begun, Mr. L. E. Fischer, a vice president and director of the North American Light & Power Co., visited me in Chicago. It should be mentioned here that Mr. Fischer had previously entered into contracts with Missouri-Kansas Pipe Line Co., for the purchase of natural gas by two North American subsidiaries—the Missouri Power & Light Co. and the Illinois Light & Power Co., both of which controlled very important markets in those two States.

Mr. Fischer was accompanied by Mr. W. G. Maguire, a broker, who had negotiated the contracts. The contracts had been offered to us some months before by Mr. Fischer, on the condition that Missouri-Kansas Pipe Line Co. abandon its plans to supply natural gas to Omaha, Nebr., which at that time was regarded as a potential market also by interests that Mr. Fischer represented.

On this afternoon of June 14, 1930, when Mr. Fischer and Mr. Maguire came to me, Mr. Maguire was very much perturbed by the vicious opposition to our construction program that had developed among other public-utility interests.

The conversation and the events that followed subsequent to Mr. Fischer's visit are here set forth to you gentlemen of the subcommittee in the exact detail presented some months ago to the Department of Justice. In fact, I prefer to quote bodily from the report sent to the Attorney General last October, as follows:

"Mr. Fischer said that, unless I would abandon the Missouri-Kansas Pipe Line Co. project and cause that company to sell all of its gas reserves to the Standard Oil Co. of New Jersey and all of our pipe lines and pipe contracts and construction contracts to H. L. Doherty & Co., the market on Missouri-Kansas Pipe Line Co. common stock would be attacked and raided on June 16; that I would be bankrupt and thoroughly discredited, and that if I showed opposition I would even be attacked personally and slandered and my family attacked; that he (Fischer) was my friend (which statement I did not take very seriously) but that, having given us the contracts for Illinois and Missouri, he had brought down upon his head and likewise the heads of his associates, such severe criticism that he was confident that I would make a terrific mistake to refuse this proposal; that I was not capable of bucking such powerful interests as Standard Oil of New Jersey and Doherty.

"As an inducement to accept the proposal, Mr. Fischer said that he was authorized to offer my company a 15 per cent interest in the common stock of the Northern States Pipe Line Co. (then under construction toward Omaha, St. Paul, and Minneapolis) at cost.

"I replied that I could not possibly accept such a proposal and endeavored in my conversation to avoid an open break. I told Mr. Fischer that if they would give my company, in addition, a substantial interest in the Chicago Line, I could see a little possibility of getting together. Mr. Fischer then told me that he was authorized to offer us a 10 per cent interest in the Chicago Line, which I had expressed myself as feeling was not enough; and he stated that before he could offer any more he would have to consult Mr. Christy Payne, vice president of Standard Oil Co. of New Jersey, in charge of its natural-gas projects.

"I suggested that, since I could see many advantages that would accrue from the production being developed by one company—eliminating the necessity of offset drilling, duplicate pipe lines, etc.—I was in a receptive frame of mind and that I believed a proposition could be developed that would be acceptable; however, before making any commitment I preferred first to meet and talk with Mr. Payne in New York City, as I was of the opinion that he knew nothing of me other than what he might have been told by Mr. Doherty, and that I wanted to give Mr. Payne a chance to make a decision for himself as to me and my character; and, following that meeting, I would be content to sit down and endeavor to develop a solution of the problems.

"Mr. Fischer thereupon promised me a week's truce, meaning that the market would not be raided for a week.

"The following day I proceeded to New York. Upon my arrival, however, I learned that our stock market had already been attacked and was under heavy pressure. All of my supporting bids, approximately 100,000 shares at 36⅛ to ¼, were filled before I could possibly withdraw them.

"I would not have allowed these large orders to remain in the market in the face of an attack by Standard Oil and Doherty, as I fully believe that had I placed larger orders in an attempt to catch them in a short position, trading in our stock would have been suspended and so much adverse publicity directed at us that a large amount of real liquidation would have resulted, permitting the shorts to cover and bankrupting me. The orders to the extent of 100,000 shares, which I kept on file as a precaution, due to previous attacks that the market had suffered of a smaller nature, proved to be of insufficient volume to discourage this attack.

"Mr. Fischer telephoned Mr. Maguire that he had been unable to effect the truce that he had promised, and implored him to reach Christy Payne immediately.

"In this connection, the Standard Oil of New Jersey owned a 25 per cent interest in the Chicago Line, in addition to which Cities Service owned 25 per cent, Insull, 25 per cent, and the Producers' group, 25 per cent. This latter group consisted of Standard Oil of New Jersey, Texas Oil, Columbia Carbon, Phillips Petroleum, and Skelly. It is my understanding that of this Producers' group, Standard of New Jersey owned the major portion, giving them the largest interest in the Chicago Line.

"We were not able to see Mr. Payne on the day of the raid until 4 o'clock in the afternoon. On entering his office we found Mr. R. Carr with him. Mr. Carr, I understand, is president and counsel for Columbia Carbon Co. Mr. Maguire was also present.

"Immediately after introductions, Mr. Payne smilingly asked: 'How do you like it?' I said, 'How do I like the market of Missouri-Kansas?' He just grinned, and I replied that it was 'not too bad.'

"I then told Mr. Payne in general my entire experience from the time of my first introduction to Shippey and Maddin (the partners who had invited me to join them in 1927 to develop gas lands in the Kansas City area), with the hope that he would be impressed with the soundness of my conduct. This, however, appeared to be a waste of time, the interview having the atmosphere of one wherein they had cast their die, the market was raided, the destruction was under way, and they had no desire whatever to reconsider. This conference lasted about an hour and a half."

These details that we have furnished to you, gentlemen, have been withheld from the public for more than 20 months in the hope that we could, unaided, win our own battle. In the meantime, however, my own character and that of our management has been assailed and slandered, and no effort has been spared in the attempts to wreck Missouri-Kansas Pipe Line Co.

The bear attack of June 16, 1930, drove our common stock down more than 20 points from an opening quotation above $36 per share. Its effects have been disastrous to this day, for not only has the company suffered a financial loss mounting into the millions of dollars thereby, but our 21,000 stockholders in 46 States of the Union have likewise been innocent victims. Their confidence in our ability and integrity has been impaired or virtually destroyed, the available markets for natural gas have been shut off from Missouri-Kansas Pipe Line Co., and practically every source of credit has been closed.

To rescue our enterprise from total collapse, the Missouri-Kansas Pipe Line Co. was forced in September, 1930, to dispose of a 50 per cent interest in the $40,000,000 natural-gas pipe-line system then under construction from Texas to Indiana, known as the Panhandle Eastern Pipe Line Co.; it has been compelled to halt the investment of additional capital in the development of its natural gas reserves in western Kentucky, and in pipe lines in that State and in Indiana.

Certain other natural-gas pipe-line and utility interests seemingly deny Missouri-Kansas Pipe Line Co. a right to exist, fearing the invasion of natural gas at a fair price and the consequent demoralization of their own exorbitant rates for gas heat. This may be a strong statement, but we stand prepared to prove these assertions before any committee that may be appointed.

There is a rank odor in the natural-gas industry as it is being conducted to-day, and that odor does not arise from the commodity itself. While propaganda to liberalize the Sherman Antitrust Act has flooded the Nation, certain conspirators have themselves embarked upon a policy of "rule or ruin," and short selling has been but one of their weapons in clubbing those who stand in their way.

Respectfully submitted.

FRANK P. PARISH,
President Missouri-Kansas Pipe Line Co.

NOTE.—Appended herewith are copies of certain newspaper comments submitted for the record.

NEWSPAPER COMMENTS ON BEAR ATTACKS AGAINST MISSOURI-KANSAS PIPE LINE CO. COMMON STOCK

[From the Chicago Tribune, Monday, May 5, 1930, Chicago stock activities, reported in May 6 issue]

CHICAGO LIST RALLIES; SINKS, THEN CLOSES UP—VOLUME SETS NEW RECORD—MISSOURI-KANSAS PIPE LINE GAINS AS "SHORTS" ARE SQUEEZED

(By Maurice Fisher)

* * * The performance of corporation securities and Missouri-Kansas Pipe Line attracted considerable attention. * * *

Missouri-Kansas Pipe Line opened in a block of 11,000 shares at 30⅜, a fractional gain, and, despite the weight of large offerings, pushed ahead as shorts began to get squeezed, to register a new top at 34. A block of around 4,000 shares was bought in by shorts for cash at 34, the stock reaching a top of only 31¼ in the regular transactions.

[From the Chicago Tribune, May 7, 1930 issue]

Missouri-Kansas, still harboring a heavy short interest, pushed ahead to equal its high mark for the year at 31¼.

[From the Chicago Daily News, May 7, 1930]

MISSOURI-KANSAS PIPE LINE

(By Royal F. Munger)

Bears do queer things at times, but in the raid on Missouri-Kansas recently the bear element on the Chicago Stock Exchange appears to have acted without adequate investigation. Any salesman for Missouri-Kansas Pipe will tell you that he is urged to sell stock chiefly on the installment plan. Obviously, where considerable blocks of stock are tied up in this fashion, any selling by outsiders is bound to run into a pocket.

While the subject is up it might be worthwhile to state that nothing has been discovered to indicate that Francis I. Du Pont was acting for the rest of he famous Du Pont family. Francis I is understood to be a man of considerable wealth in his own right and his holdings of Missouri-Kansas are estimated by Frank P. Parish, president of the company, at more than 20,000 shares.

[From the Chicago Tribune, May 6, 1930]

(By Thomas Furlong)

The short interest in Missouri-Kansas Pipe Line, which is said to amount to about 65,000 shares, was one of the interesting situations in yesterday's market. Short sellers bought 7,450 shares of the stock for cash and immediate delivery at prices ranging from 30¾ to 34. The highest the stock got on ordinary trades was 31¼. Approximately 52,000 shares changed hands between 30 and 31. It was said to be extremely difficult to borrow stock because such a comparatively small amount is held in brokerage accounts. Unofficial estimates place the number of shares available considerably below the number which traders are said to be short.

[From the Chicago Tribune, May 7, 1930]

PRICES RALLY SMARTLY HERE—VOLUME LAGS—PIPE LINE SHORT INTEREST STARTS DISCUSSION

(By Thomas Furlong)

The tight position in which short sellers in Missouri-Kansas Pipe Line found themselves during the recent slump in the market has brought to a head a problem which the exchange has already attempted to solve through the establishment of a stock-loan department. The scarcity of the stock for loaning purposes compelled several short sellers to cover at prices above the market and led to discussion of possible action by exchange governors.

WILL MEET TO-DAY

Governors of the exchange will meet to-day and consider the situation. What action may be taken is not known, but it is believed an attempt will be made to improve the stock-loaning faciilties in Chicago.

Trading in Missouri-Kansas was comparatively light yesterday. The price held steady between 30 and 31 on sales of 6,000 shares. One transaction for 100 shares was made for cash at 33. According to officials of the company there was less than 50,000 shares held in brokerage accounts last Friday. This is considerably less than the estimated short interest which existed in the stock. Retail distribution of the stock is being carried out at the present time. Last Friday 128,000 shares had been delivered and paid for, according to Frank P. Parish, president.

(Thereupon, at 12 o'clock noon, the subcommittee adjourned until the following day, Saturday, March 5, 1932.)

SHORT SELLING OF SECURITIES

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HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

SEVENTY-SECOND CONGRESS

FIRST SESSION

ON

H. R. 4, H. R. 4604, H. R. 4638
H. R. 4639

MARCH 5, 1932

(CORRECTED)

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SHORT SELLING OF SECURITIES

SATURDAY, MARCH 5, 1932

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE NO. 3 OF THE COMMITTEE ON THE JUDICIARY,
Washington, D. C.

The subcommittee met at 10.15 o'clock a. m., Hon. Tom D. McKeown (acting chairman) presiding.

Mr. McKEOWN. The committee will come to order. Judge Sabath, you may proceed. The members of the subcommittee have been asked to be here, and we have been waiting for them, and they will be here in a few minutes; but we have to adjourn early, because the House meets at 11 o'clock to-day.

Mr. SABATH. Yes, Mr. Chairman; I appreciate the conditions which exist in that respect.

Mr. MICHENER. May I suggest to the gentleman from Illinois (Mr. Sabath) before he starts, that, like himself, I have to be at a meeting of the Rules Committee at half past 10; and I do not want him to think that I am discourteous when I leave this meeting.

Mr. SABATH. Yes; I know that. We have a very important matter before the Committee on Rules to-day.

STATEMENT OF HON. ADOLPH J. SABATH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. SABATH. Mr. Chairman and gentlemen, I fully realize and appreciate the conditions which confront the members of this committee, as well as those of other committees, at this time. We are all going at full speed, trying to enact legislation to relieve the unfavorable and unbearable conditions that exist in the country to-day.

Therefore, I am going to try to be extremely brief, realizing, as I do, that the House meets at 11 o'clock to-day, and that the Rules Committee, of which I am a member, and which meets at 10.30 o'clock, has important matters to consider.

In view of my desire to familiarize the members of this committee with the facts concerning the transactions and practices on the stock exchanges, and in the hope that in the near future the members may be able to glance over some of the evidence, I am going to ask leave of this committee to permit me to embody in my statement a few extracts from editorials written by outstanding and uncontrolled financial writers——

Mr. McKEOWN (interposing). Are those very long extracts that you wish to insert in the record, Judge Sabath?

Mr. SABATH. Well, many of them are long; but I will endeavor only to put in short extracts, because I myself have not time to arrange them as I should like to.

Mr. McKEOWN. All right.

Mr. SABATH. I was hopeful that I would have about a day in which to present my facts to the committee and that I could have read some of these extracts and statements; but unfortunately, time will not permit it.

Mr. CONDON. Do these editorials refer specifically to your position in introducing these bills?

Mr. SABATH. I have many that do; but those that I wish to insert into the record are confined to a discussion of the practice of short selling and the abuses on the stock exchanges; some also show that the existing conditions at this time are not all due to short selling—which I concede—but that they are in great measure due to the manipulation by the "bulls" of 1928 and 1929 who created and caused the terrific, criminal inflation of stock-market prices during those years—the same individuals who are the "bears" of 1930, 1931, and 1932.

Mr. CONDON. Do these articles name some of these men or do they just refer to them as a class?

Mr. SABATH. Yes; several name some of these men. But I have up until now refrained from giving the names of men who have been charged with being outstanding "bears."

I have no direct evidence, because I have not examined their books; but I have received many communications charging some of our largest financial institutions and many of our outstanding men with the practice of short selling. But I never wish to attack anyone——

Mr. McKEOWN (interposing). That material will be admitted. Let the record show that that is to be admitted.

Mr. Max Bruell, former stock-exchange member, has this to say in the November 8, 1931, issue of the New York American:

SAYS SHORT SALES NOT JUSTIFIED IN TIME OF DEPRESSION

Short sales, perhaps economically justified in normal times, become a menace in periods of depression. The attempts of the New York Stock Exchange to restrict short selling are half-hearted. The only effective method, as practiced by foreign bourses, is to insist upon actual presentation of securities prior to their sale. This can be amplified by prohibiting the lending of securities. To facilitate selling of securities held abroad, a foreign central agency could be appointed. Upon receipt of cable advices confirming that the respective securities were duly delivered to the agency, selling orders could be executed.

Due to public criticism, and in an endeavor of self-preservation, the New York Stock Exchange had adopted a number of necessitous reforms. The ultimate goal, to reduce the exchange to its normal functions, is as yet far from accomplishment. The governors of the exchange are attempting to popularize their institution. Speeches of the President, carefully prepared are widely circulated. The machinery of the exchange has even been filmed. The film shows the course of an order from its inception to its settlement. The film, however, does not reveal that quite often customer's orders serve as protection for the private speculations of floor brokers and specialists. To do so with more or less impunity has been their time-worn privilege. The system is detrimental to the client and indefensible.

As long as the exchange permits its members to act as brokers and as dealers, the assertion on the membership certificates:

MEANINGLESS PROMISE

That the exchange has been formulated for the purpose of maintaining high standards of honor among its members and for promoting and inculcating just and equitable principles of trade is rather meaningless. It is a lame excuse that without the specialists no markets in certain securities would be obtainable.

The specialists make markets if they feel like it; they play safe.

The controversy about specialists has cropped up very often, but no action has been taken. Should future Federal or State supervision remove the trading privileges of the specialists exchange seats would decidedly become less attractive. Specialists in active markets have rolled up fabulous incomes. Their profits were derived from the undue advantages held over the general public. The methods of practically victimizing clients in stop loss orders, subscription rights, part paid stocks, etc., are plentiful.

The public lives in a delusion that listing a security on the exchange is an indorsement of its merit. This is utterly unwarranted. The listing committee of the exchange is primarily concerned about the assurance of an open and free market and does not verify the correctness of balance sheets as practiced on continental exchanges. The grossest overcapitalization of companies has not been checked by our exchanges.

PUBLIC EXPLOITATION

Shall we permit such exploitation of the public to go on forever or shall we move for supervision to bring security issues in line with physical value? Must we continue to permit houses of issue to escape responsibility through the time-worn clause on prospectuses.

This information, while obtained from reliable sources, is not guaranteed by us.

Nation-wide extension of ticker facilities and brokerage branches was a mistake. Customers' men have only one function—to rake in commissions. According to recent regulations, they are required to have some experience but many of them would not pass an intelligence test. No charge is being made for market letters. One of our great economists states that they are supplied gratis because they are not worth more. The exchange firms ordinarily do not affix their signatures to opinions furnished; they prefer to let the economist assume responsibility.

We should be less concerned about the investment value of 1,375 New York Stock Exchange seats than about the wisdom to engage in gambling with all odds against the public.

If Congress and State will deal with some of the points outlined above, the return of confidence will be speeded.

Mr. B. C. Forbes, editor and publisher of Forbes, who was one of the first to see the disastrous effects of short selling, writes as follows in the November 1, 1931, issue of Forbes:

SHORT SELLING IS NOT TIMELY

Those who try to send stock prices to perdition by selling them short should be honored as supreme patriots, as saviours of their country. That is the conclusion one almost reaches on listening to President Richard Whitney, of the New York Stock Exchange. Why such benefactors should have been

forbidden to exercise their laudable operations for even 48 hours is hard to understand—but not quite so hard to understand as why they were again told to resume depressing quotations.

It was, we are officially told, "an emergency" which induced bridling the bears. Apparently "emergency" conditions lasted only two days. You and I and a good many others have been under the painful—very painful—notion that emergency conditions have prevailed considerably longer than 48 hours. Ask the hundreds of thousands of depositors in banks which closed their doors if normal conditions have been restored. Ask millions of unemployed the same question. Ask, also, investors whose income has been stopped. Ask other investors who, on the recommendation of reputable bankers and others, purchased securities at 1929 prices and who have lately found themselves bankrupt.

Mr. Whitney protested too much about the blessings conferred on the world by bears. A security market without short selling was pictured one moment as unthinkable, impossible. The next moment came the statement that the bond market has existed for generations without short selling. Yet which market has experienced the wildest inflation—the stock market, enjoying the wonderful "stabilizing" miracles wrought by short sellers, or the bond market not enjoying short selling?

I, for one, would have had more confidence in buying stocks during the depths of the debacle if aware that quotations could not be slaughtered at any moment by short sellers. What this country has mainly suffered from lately has been fear. Investors would have felt less apprehensive had they known bear selling was banned. Mr. Whitney's own figures were meant to convey that the amount of short selling was a mere bagatelle. Yet he argued and argues that this mere bagatelle is of such infinite importance that the New York Stock Exchange authorities will court legislative action rather than comply with overwhelming public opinion.

Admittedly, a wide open market is ideal. But to permit short selling during a period of hysteria such as has shaken the financial foundations of this Nation is not ideal in face of mounting public hostility. Even the powerful New York Stock Exchange must, if it is to be allowed to function with a maximum of freedom, take cognizance of the public will.

And in the November 30, 1931, issue of the Chicago Herald and Examiner:

FORBES WAXES WROTH OVER BEAR MANEUVERS

Good morning! Have you had your daily cry?

That greeting is addressed mainly to those identified with Wall Street.

The rest of the country is preserving its sanity and attending to business in a rational sort of way.

But the Wall Street world daily conjures up new hob-goblins and runs frantically to cover. The bears never found it so easy to make money, never found it so easy to cause fright, never found it so easy to spread the idea that the bottom is about to fall out of everything.

Thanks to the secrecy with which short-selling is hedged about by the New York Stock Exchange governors, we are kept totally in the dark as to how much bear raiding is going on. The market has every appearance that the bears have been having a perfectly lovely time, with the sky the limit—or, perhaps one should say, hades the limit.

Of course, did an "emergency" exist, the stock exchange governors would halt the bears' picnic—perhaps for as long as 48 hours. You may remember that they did that once before. That was when stock quotations first reached the depts they again reached at the end of last week.

But apparently there is no need whatsoever to ban short selling at this time—in the eyes of the exchange governors. In the eyes of a very large section of the public there is need for stopping short selling until stocks and bonds have reasonably recovered from their ultrapanic prices.

Incidentally, bonds are distinctly lower than they were when the bears were last prohibited—for 48 hours—from carrying on what President Whitney of the stock exchange asks the public to believe are laudable, nation-saving operations.

Would it interest the stock exchange authorities were they to learn that not a few investors, although they recognize current quotations as extraordinarily low, refuse to make purchases of stocks under existing conditions, so long as bears are at liberty to knock down any stock they choose to bankruptcy prices?

Of course it may be that the so-called restrictions on short selling have been enforced so rigidly that the public is all wrong in imagining that any short selling whatsoever has been going on. The stock exchange governors know the facts. The customers of the exchange are denied the facts.

Maybe a few months or a few years from now the exchange authorities will graciously conclude to reveal the truth—after such information is totally worthless.

The prospect is, however, that the public will call upon their legislative representatives to uncover the facts, not a few years from now, but a few months from now. My conviction, based on rather intimate association with financial leaders, is that Wall Street hasn't the slightest conception of the ill-will borne it throughout the continent.

If the stock exchange governors were more fully informed on his point, I rather think they would do more than they have yet done to stave off political action.

In the Chicago Evening American, of February 9, 1932, Mr. R. P. Vanderpoel, financial editor and sincere proponent of the policy of laissez faire on the exchanges, makes this interesting and forceful statement in regard to short selling:

BEAR RAIDS—EXCHANGE MUST ACT—SNEERING TRAITORS—TRAMPLE ON THEM

Repeatedly of late there have been evidences of deliberate efforts upon the part of organized bear cliques to depress security prices.

As one of those who have steadfastly argued for the maintenance of a free and open market and consequently against the elimination of short selling, I feel it a duty to express my opinion, and in the most forceful terms, against permitting any individual or any group to hammer stock prices down at this time.

I believe in free speech just as I do in a free market. Yet in war time, there are certain restrictions on free speech. A man may not be a traitor to his country.

AIDING THE ENEMY

We are passing through a period now just as critical as though we were engaged in a great war. It is just as essential that the devastating downward crash of prices—security and commodity—be arrested as it would be to halt the forward march of an alien enemy.

Yet we are permitting men to spread propaganda just as seditious as anything that might be put out by an enemy. Not only that, but through the stock exchange we have allowed these traitors to train their guns on what appeared to be our vulnerable spots.

If this condition continues much longer there can be but one end—closing of the stock exchange for self-protection by an outraged Nation.

IT WILL NOT

The United States Government has set up the Reconstruction Finance Corporation as a stupendous effort to check the great tide of deflation that has already resulted in so much suffering and which threatens economic collapse on a world-wide scale. The Government is putting $2,000,000,000 behind this movement.

Every fresh onslaught on the stock market makes the work of this corporation just that much more difficult.

Does anyone believe that the Government will stand idly by and permit a group of sneering, traitorous men "play" with the stock market for their own personal aggrandizement, disregarding the general welfare of a Nation?

It can not and it will not.

This column has consistently defended honest short selling. Bear raids have always been condemned in the strongest language. Market manipulation of any kind has never been countenanced.

What de we find at the moment?

Unless our interpretation is totally wrong, we find a well-organized group of bears, men whose names have been bandied about from coast to coast, very carefully, very cleverly, putting out an increasing line of short stocks.

We find the most bearish sort of propaganda emanating from these same bears and their paid agents.

We find these men planning to profit through their short lines by uncovering specific weak situations and hammering at them in the hope of breaking them and thereby causing such a smash that they may cover their short commitments at a handsome profit.

MUST ACT QUICKLY

Is this a fanciful picture?

We do not believe that it is. Bankers, business men, members of the stock exchange themselves, tell us that it is not.

If it is a true picture—even approximately true—the New York Stock Exchange must take drastic action quickly or an impatient citizenry will speak through its Congress in no uncertain terms. * * *

CALL OF THE HOUR

This is no time for trifling.

The call of the hour is for men of strength, courage, and faith—men who will carry us forward, trampling as they go on the traitors and the cowards.

The following editorial appeared in the Chicago Daily Times on February 24, 1932:

MEDICINE FOR "SHORT SELLING" ISN'T STRONG ENOUGH

The New York Stock Exchange has revised its rules on short selling of stocks, to be effective April 1. The action comes about 18 months too late. What's more, the new rules do not go far enough. Short selling may be restricted a little. In times like these it ought to be abolished. The President and Congress have set in motion many governmental activities, designed not only to stop the depression of values but actually to inflate them. Billions of dollars of public money are involved in the various schemes. The entire population of the country is expected to put its shoulder to the wheel and push for higher values, more business, more employment, and better times.

But the short seller gambles that these objectives will not be accomplished. He is not an inflationist. He is a deflationist and a depressionist. He bets that things will go lower, not higher. He makes money out of destruction, not construction. He "sells" a stock at a lower price than the current quotation with the purpose in mind that his "sale" will depress the market even under the value at which he "sells." Then, if his hunch works, as it usually does, he buys it at the bottom price and delivers it to the buyer in his original sale, making a profit.

But he sells something he does not own. To accommodate him in his gambling, his broker lends to the short seller stock that belongs to another customer which the broker is holding on a margin arrangement. The other customer doesn't even know that his stock is being used this way; often the other customer is the loser in value through the very transaction for which his stock has been put up as dummy merchandise.

Under the new rules, as announced by President Richard Whitney of the New York Stock Exchange, the broker must secure the other customer's specific written consent to have his stock lent to a short seller. Even under this plan, the short seller is selling what he does not possess, another man's goods. The plan leaves room for manipulation and does not guarantee what the country needs * * * a ban on gambling against prosperity.

The argument for short selling has been that it provides a "cushion" for a sagging market, since whenever the bears sell they must later buy back. But the public feels that the need of the day is for prices which reflect, not the results of manipulation, but something close to the actual value of the securities bought. In a period like the present, when millions of families are destitute, due to lack of business and unemployment, short selling of securities means short selling of the United States and its people. It is gambling against their climb up the economic ladder. It is making money out of human misery.

The stock gambling fever was largely responsible for the depression in the United States. The 1928 and 1929 stock boom was due to stock gambling that was made possible by credit. The Federal reserve system could have choked that credit in time to stop the gambling and prevent, or at least, minimize the panic. The Government's banking system did not take the necessary bold step then and stock prices took balloon ascensions. They are now deflated below actual values. Credit should be denied to those who gamble to keep them lower than they should be. All short selling should be stopped in the national emergency.

Mr. SABATH. But I will refrain from inserting any name in the record, unless I am positively certain that there is clear evidence that such an individual has practiced this and been guilty of this infamous practice.

Now, in my desire to bring to the committee all the information I possibly could, I dictated last evening the following statement:

Mr. Chairman and gentlemen of the committee, for over two and one-half years I have pleaded for an opportunity to appear before the committee in behalf of my bills on short selling and show the destructiveness of this practice and its effect upon the social and economic conditions of the country. And now it is somewhat of a mixed pleasure to appear before you after the destruction which I had prophesied has taken place because the President and the administration had refused to act on my appeals.

I shall not waste the time of the committee in dwelling at length on the abuses of "bull" manipulation and practices in 1927, 1928, and 1929, though I wish to state here that I am fully cognizant of the part they played in paving the way for the greatest economic debacle in the history of our country. Our task at present, and it is a task incumbent upon us, is to deal immediately with the situation now before us—the practice of "bear raiding" and short selling.

To-day I know that I am speaking for every legitimate agricultural, manufacturing, and business enterprise, as well as for the 20,000,000 men and women who have lost their life savings; for the hundreds of thousands of small business men and small manufacturers who have been wiped out; and for the millions of depositors and the thousands of widows and dependents who have been made penniless to-day by the greatest crime ever committed in our country: a crime that is responsible for throwing 8,000,000 people out of employment and, therefore, the cause of want and misery to millions of American homes. And lest I forget, a crime that is directly responsible for the death of 20,00 men of the Nation.

Mr. Chairman and gentlemen, in requesting favorable action on my bills, or any other bill that the committee may see fit to report favorably to prohibit or restrict short selling, I wish to emphasize that I am not opposed to any legitimate transactions or to any orderly or free market of stocks and bonds. But I do disagree with the assertion that without short selling we would not and could not have a free and orderly market to sell. I am confident that the elimination of professional manipulation would aid the legitimate transactions and the orderliness of the market. Furthermore, I deny that by prohibiting short selling the stock exchange would be forced to close, as Mr. Whitney stated before this committee. I do believe that the volume of business on the stock exchanges would be reduced and that the profits of the brokers and gamblers would be minimized, but on the other hand, I believe that business in general would be stabilized and confidence restored.

When I appealed to the President, the governor of the Federal Reserve Board, the leaders of the administration, and the governors of the various exchanges in 1929 to stop the practice of short selling because the coming events were already casting their shadows and it appeared as though an economic crisis was fast approaching, I was assailed and ridiculed by the writers and economists controlled by Wall Street and by the majority of the brokers. To-day, after two years and four months of patient but persistent effort, I am pleased to say that I have won over a great number of these people to the proposition that short selling is an unmitigated evil and should be prohibited.

Within the last year Mr. Whitney, president of the New York Stock Exchange, has made three stirring speeches in defense of short selling, which have been broadcast throughout the entire Nation, and has had a half million copies of the same printed and distributed throughout the country. Even a superficial examination of these speeches, as well as those delivered before your committee by Professors S. S. Huebner and Joseph Stagg Lawrence, will show that they have been carefully prepared; and in addition, it is quite

evident, from the speeches themselves and from the testimony presented by Mr. Whitney's counsel, that no expense has been spared to secure the best legal talent available to conduct this defense of short selling. But notwithstanding the ability of these men and their adroitness in handling an obviously unfavorable situation, they have failed, in my opinion, to convince any informed person, except stock exchange officials, short sellers, and brokers, that short selling is expedient or beneficial.

On page 8 of the written statement which Mr. Whitney read before this committee, he states that "if there had been no short selling of securities, I am confident that the stock exchange would have been forced to close many months ago." Mr. Chairman and gentlemen, I doubt very much whether the exchange would have closed, if short selling had been prohibited, and I question Mr. Whitney's sincerity in making this statement; but oh, what a blessing it would have been for the Nation, if the stock exchange had actually closed in 1928. Lives would have been saved; banks, factories, and shops would still be open; and above all, the people of the United States would not have been fleeced out of hundreds of millions of dollars during the years of 1928 and 1929, for there would have been no ballyhooed "Hoover bull market" with its artificial rigging of stock prices and there would not have been hundreds of new stock market millionaires born at the expense of the working people. But please remember that the men who engineered this orgy of inflation, the "bulls" of 1928 and 1929, have become the "bears" of 1929, 1930, 1931, and 1932, and that only a small number of many have been directly responsible for these manipulations, first, on the "bull" side, and, in the last few years, on the "bear" side.

Mr. Whitney and his scholarly aides have endeavored to show that the stock exchange manipulations have little or no effect upon the trend of business and that stock exchange prices are an effect rather than a cause. And in regard to the effect of short selling upon the trend of the market, Mr. Whitney reached the heights of eloquence by saying, "that it does much to smooth the waves, but does not effect the tide." And Professor Lawrence stated Wednesday, March 2, that the stock exchange does not influence business and that there is no definite correlation between stock market prices and the trend of business, and showed that in 1927, 1928, and 1929, while business was on the downgrade, the prices of stocks were going up to unprecedented heights. Now, if the stock prices on the exchanges at any time represented true value, and if they were the result solely of the law of supply and demand, I am certain that they would have followed the trend of business. The lack of correlation between stock prices and the trend of business during these years, as shown on the charts prepared by Professor Lawrence, was the result of criminal manipulation on the part of the professional gamblers interfering with the natural law of supply and demand. In this connection, permit me to read an extract from a speech I delivered on this subject in 1929:

"In keeping with this policy, ex-President Coolidge during his administration began an advertising campaign of prosperity, which Mr. Hoover followed, proclaiming that the resources of the United States were still untapped, that business conditions were showing improvement each year, and that savings were increasing. As stated in a New York World editorial:

"'* * * After a sharp decline following a report of a huge increase in brokers' loans, Mr. Coolidge amazed even Wall Street itself by announcing that neither he nor Mr. Mellon saw any danger in the expansion of brokers' loans * * *.'

"This kind of propaganda continued even after it was pointed out that depression had set in in many lines and that stocks were selling at levels ridiculously out of proportion with their earnings. But notwithstanding this warning, many other similar statements were issued from time to time to imbue the public with the confidence that stocks would never react but would keep on climbing to greater heights in this so-called 'Hoover era of higher prices.'

"The beautiful, enticing picture painted by the administration forces, who would not listen to the warning voice of economists or the threat of rapidly rising brokers' loans, furnished a rife field for corporate promoters. New corporations were organized for exploiting purposes, old corporations split up their stocks, gave so-called rights to purchase additional stock, and all the old tricks and many new ones were used. No trouble was encountered in listing these issues on the various old and hastily organized new exchanges. Interest rates increased. Country banks were lured into sending their cash to New York for use as 'call loans.' Corporations sent to the 'call loan market' not only their huge surpluses, which should have been distributed among stockholders, but

also the moneys received by increases in capitalization, which had been obtained for development and expansion.

"The people, impressed with the assurances of the administration, were easily taken in, and buying of all kinds of stocks reached new levels daily. Large corporate interests, with their capital stock increased by millions of shares, easily induced even their own employees, by means of alluring reports, to become 'partners' in these great industries, and every conceivable scheme was resorted to in order to unload these stocks at artificially created prices on employees, their families, and the public. Then came the pyramid of pyramids—the investment trust—a new medium for obtaining millions upon millions of dollars from a misled and inflamed public.

"Nearly everyone was in. Now for the first time the Federal Reserve Board served notice that brokers' loans were excessive and must be decreased. Rediscount rates were increased; interest rates soared; credits were curtailed and moneys gradually withdrawn.

"Conditions were ripe, and the Wall Street pirates, the 'shorts,' were ready. They were not going to mold or construct but to hammer and pound to destruction. The first drastic decline was not enough. The conspirators continued unmercifully to throw upon the market thousands upon thousands of shares of stocks which they never owned with the sole purpose of destroying the market value of securities in order that they could repurchase them at their own prices and reap the richest harvest in the history of the Nation."

Yes; business started on the down grade in 1927, as Mr. Whitney and Professor Lawrence stated, because the people started to invest in stocks and bonds. The business men, the manufacturers, the professional men, in fact all classes of people, withdrew their savings from the banks and in many instances from the building and loan associations to buy securities, being encouraged in this by the leaders and financial prophets of the Nation. And what was the result? Just this. By the fall of 1929 most of the available cash had disappeared, because it had been ruthlessly and brazenly taken away from the people and out of circulation. The country, in fact, was drained dry of liquid money, and with this draining went the purchasing power of the country. Business and industry were left stranded, because the banks and the brokers demanded additional collateral and payments.

I believe it is clear to any thinking person that the stock exchange has had a potent effect upon the existing conditions and that to a great degree it has been responsible for the crash and the panic from which the country is now suffering. But, lest it may appear to any person that this statement is entirely too subjective or unfair, I shall take the privilege of introducing at this point a few remarks appearing in a leading French periodical and representing an objective point of view toward this matter:

"The main theme of conversation these days in all civilized countries is: What happened in Wall Street? How is it possible that the richest country in the world should threaten the stability and integrity of the commercial and industrial life of two hemispheres? Who is responsible for this unheard of cataclysm?

"For weeks already most disconsolate messages are coming from New York and each message is more disheartening than the previous one.

"On October 20 it was stated that the spectacular crash of the stock market had ruined tens of thousands of small speculators and involved a depreciation of security values variously estimated at from ten to fifteen billion dollars. It was added that groups of leading financiers met to consider the situation, which affected every part of the United States.

"On October 24, it was reported from New York that Wall Street experienced the greatest of all stock market crashes, that 12,800,000 shares were sold within a few hours, that the supreme crash came with a vengeance and surpassed anything that the most gloomy had predicted. The estimated loss of values was given between five and ten billion dollars.

"On October 28, a second and still greater break in the foremost American stock market took place; it was intimated that sales during the day totaled 9,200,000 shares and that billions of dollars were again dropped in quick time in spite of reports that heavy support by bankers was forthcoming.

"On October 29, it was reported that the crash of the day before characterized as the greatest in history, was not more the greatest, that 16,400,000 shares were sold involving losses of $60,000,000,000. It was stated that the stock market crash wiped out more fortunes and made more paupers than the terrible slumps of 1907 and 1920.

"All the great New York banks could do, however, was to mobilize their professional bankers. Mr. Charles Mitchel, of the National City Bank of New York, Mr. Francis H. Sisson, vice president of the Guaranty Trust Co., Mr. Alfred P. Sloan, president of the General Motors Corporation, have made bullish statements in which they reassured the world that they were 'bigger bulls than ever,' and that 'recessions resulting from the action of the market will not be violent or of long duration.'

"The United States Government also thought it opportune to reassure the public. Its spokesman, Dr. Julius Klein, Assistant Secretary of Commerce, and an authority on economics, was directed by the President to assure the millions of anxious American listeners through wireless transmission regarding the crash on the stock market, that 'regardless of regrettable speculative uncertainties, the industrial and commercial structure of the Nation is sound.'

"But, up to the middle of November, there was no 'comeback' in Wall Street. It is generally admitted that about 5,000,000 people have been speculating and that approximately $200,000,000,000 were lost; that is at an average of $40,000 each.

"Now, how was it possible? Well, for the benefit of those who have not read the first issue of Paris-New York, we shall reprint in part what Grau-Wandmayer said in May last, in his article The Orgies in Wall Street:

"'It is impossible to let pass in silence the gigantic rascalities of a gang of men, mostly international pirates, who are the dominating figures in that pandemonium called Wall Street and who are on the best way not only to loot 120,000,000 Americans, but to defraud a whole world, to undermine the very foundations of the whole economic structure of all countries; who are debauching millions of honest men and women to the detriment of struggling nations and whose only object is to plunder and to steal.

"'Aided and abetted by scurrilous politicians, Wall Street sharpers have coined a slogan that "America is enjoying unusual prosperity" and under these false pretenses they have succeeded in causing an inflation of values, which is surpassing the most optimistic dreams of windbags and financial tipsters and the hopes of charlatans offering their shoddy financial wares.

"'From 8,000,000 to 12,000,000 shares are being turned over daily on New York exchanges and over counters and the money required day by day for gambling purposes amounts to $10,000,000,000.

Never in the history of any country has such a horde of men and women with little capital and financial experience been lured to the center of speculation, and never in the history of any country was gambling so boldly and officially encouraged as in the United States during the last few years.'

"The author of the above-mentioned article further cited serious authorities who claimed that the pretention of those who indirectly influenced the great public to gambie by constantly telling that the country is prospering as never before, was untrue and misleading.

"Said Grau-Wandmayer:

"'A short time ago, no less an authority than the National Industrial Conference published the results of the investigation of 30 trained statisticians operating under the guidance of said National Industrial Conference, which shows that the "prosperity" of the United States during last year was spotty in character and that there was a decidedly marked contrast between the extraordinary high level of financial activities in Wall Street and the lower volume of general business. It was stated in the report that available statistical data for December in January last do not indicate any marked change for better or worse in the general business situation which characterized the past year as a whole. Furthermore complete statistical information made it clear that, so far as prevailing measurements of business go, 1928 was a year of less than normal growth in general business activities in the United States.

"'The year was notable only for a few months of high activity in iron and steel, in automobiles and related industries, and in building construction.

"'It is now being conceded that the "prosperity" in the United States is only a paper prosperity with stock gamblers taking all the profits. The people as a whole are not only better off than they were years before, but the middle classes are being pauperized through the well-known process of inflation.'

"There can not be the slightest doubt about it that the Wall Street disaster will ruin business in all parts of the world and that we may face prolonged hard times. The collapse was so titanic and far-reaching that its catastrophic results can not yet be grasped.

"In former market panics only relatively few persons were affected. Stock speculation in former times was confined to a small portion of population. At the time of the great deroute 17,000,000 people were registered as stockholders.

"Now, what is the United States Congress going to do about it? * * * The trouble is that the majority of American legislators speculate at various times on various exchanges and that the so-called financial leaders are fundamentally dishonest. All those bankers who tried to oppose or actually defied the action of the Federal reserve bank which tried to discourage speculation have acted in bad faith. We wish to mention only the nefarious rôle played by the president of the National City Bank of New York, Mr. Charles Mitchel, who boldly denounced the restrictive action of the Federal reserve bank tending to curb speculation.

"The National City Bank of New York, that greatest bank in the country, is particularly unlucky in its selection of men to whose supposed integrity people are intrusting their money. It must be remembered that one of its former presidents was responsible for the fact that the American people have lost nearly a hundred million dollars in Russian securities; that his successor, Mr. Stillman, was involved in a tremendous personal scandal before the courts in New York; that the National City Bank's sugar speculations in Cuba resulted in almost ruining that country, so dependable on Wall Street. Now, it is its present first executive, formerly its first bond salesman, who tried to prevail on professional gamblers to defy all warning, to hold on, because his bank profited so enormously by lending money on exorbitant rates and also by inviting the banks of the world to divert the funds intrusted to them for legitimate purposes and to send those funds to the City Bank for speculative broker loans. The National City Bank had to close in 1923–24 about 40 branches in all parts of the world, because people distrusted that bank's management, and now the same bank is again penetrating foreign countries looking, as it seems, this time for foreign capital to support Wall Street speculators.

"We regret that lack of space does not allow us to give to our American readers a short review of some of the foremost European papers regarding the New York stock-market disaster. It would be interesting and instructive. These papers are mostly reserved in their utterances, but the gist of their comments is 'Cave Americanem.'"

In 1929 the officials and directors of large corporations, being well aware that securities were selling far above their intrinsic value, began to sell "against the box," as the term goes, to protect the gains made in the value of the stock they held—stock that had been gyrated to dizzy heights by "wash" sales, false reports of fabulous earnings, pool manipulation, and misleading financial reports. Mr. Whitney naively disclaims any knowledge of such practices and asks for proof. I must state that my evidence is purely circumstantial, yet such factual evidence as exists—and make no mistake about it, gentlemen, it exists—is confined to the exchange members themselves. And how, I ask you, can one derive any knowledge of a corporation unless one has access to the records? These records are proof, and this explains Mr. Whitney's solicitude in preventing an examination of the exchange records.

Professor Lawrence stated that he sympathized with the poor unfortunate short sellers; he gave us figures of the cost of short selling and endeavored to show us what the short seller contributes. That being the case my bill will protect the short seller, and he should have no complaint. Professor Lawrence also pointed out that the unlisted stocks and the stocks not sold short suffered as great a deflation as those sold short. It is amusing for me to note what little respect these professors and New York lawyers have for the intelligence of the Members of this House. Do they not know that these unlisted stocks and bonds naturally follow the trend of the listed stocks and that bonds have suffered because many people in despair have been forced to sell their bonds and unlisted stocks rather than sacrifice the listed stock which they bought at the boom period with the encouragement of our financial and political prophets? Does Professor Lawrence feel that we do not know that the value of bank stocks is bound to be affected when billions upon billions of deposits have been withdrawn from the banks and from the legitimate business channels?

In addition, he has stated that there are 10 "bulls" to 1 "bear." Up to a year ago the percentage was much greater, but due to the publicity which the "bears" have received the ratio on the "bear" side has naturally increased. And this, I believe, is another important reason why short selling should be prohibited or restricted without delay.

There are other and more urgent reasons why we should legislate in this regard before it is too late. Thousands of people in an attempt to recoup their losses have again been "taken in" and deprived of their last penny. It is to protect those who have lost everything and are in despair and who will be tempted to take long chances in order to recover their losses that we must curb this vicious practice. And above all, it is to prevent a recurrence of the cataclysm in which we now find ourselves; a cataclysm which robs a people of their finer qualities and in passing leaves them cinderlike—hard, scarred, and misshapen. The great mass of the American people will never forget the haunting memory of these years and will censure us if we do not act, and act quickly.

Although you may or may not agree with me that it is a fair statement, yet I do not believe it brings home to you gentlemen all of the facts that I would like to have you know. Therefore, I will just ramble along and give you any outline of my efforts to correct this evil.

Short selling, gentlemen, is not a new question with me. I have been opposing it for more than two decades. However, it was not until 1929, when conditions appeared timely for a gigantic social and economic upheaval, that I began to attack this practice in earnest. I have been through several panics and crises and was acquainted with the conditions leading up to them as well as the part played by the short sellers. Gentlemen, we look with horror upon the ghouls who slink about under the cover of darkness to rob the dead. Yet, these men under a cloak of respectability move about spreading false rumors, preying upon the fears and shortcomings of men, and breaking down the confidence of the people in our industry, our institutions, and our Government. The ghouls rob the dead; these men rob the living of their life savings and the Nation of its life blood. And yet nothing is done about it. Some day posterity will look upon the stock exchange manipulations and practices of 1928–1932 as the greatest crime committed upon the people of the Nation, and will hold those who had the power to stop these practices responsible for the great catastrophe that has occurred.

You are undoubtedly aware of the fact that the wealth of the Nation, due to the manipulations in stocks, has been reduced by nearly one hundred and fifty billions of dollars; that the stocks which are listed on the New York Stock Exchange and other exchanges are worth only 20 cents on the dollar; and that although their former value was about $170,000,000,000, to-day it is about $32,000,000,000. And when we take into consideration that in this terrific crash over 20,000,000 of our people have been imposed upon and made nearly penniless, when you will agree with me, I know, that we have permitted conditions to exist which should have been prohibited long ago.

In November, 1929, when I saw what was going on, I wired the President, asking him to stop this abuse. I also sent telegrams to the chairman of the Federal Reserve Board, the Secretary of the Treasury, and the presidents of the stock exchanges.

And a few days afterward, the officials of the New York Stock Exchange issued the so-called "questionnaire," requesting brokerage houses to make reports of the short sales. Of course, you know that the market immediately righted itself, and that it went along that way for two weeks until the officials saw fit to rescind the ruling; and then again the crash continued.

Mr. CONDON. What was that date? Will you put that in the record now?

Mr. SABATH. That was November 14. Now, may I insert here in the record, Mr. Chairman, my telegram to the President?

Mr. MCKEOWN. Yes.

Mr. SABATH. And to Mr. Mellon; and to the chairman of the Federal Reserve Board; and to the board of governors of the New York Stock Exchange? I did not know then who the president of that exchange was, and so I addressed my telegram to the governors.

I wish also to insert the answer which I received on November 14, 1929.

Mr. MCKEOWN. Will you read those messages?

Mr. SABATH. The answers?

Mr. MCKEOWN. The messages and the answers.

Mr. SABATH. I have the answers and I have some of the telegrams.

(The following telegrams are those referred to:)

CHICAGO, ILL., *November 12, 1929.*

His Excellency, HERBERT HOOVER,
President of the United States, Washington, D. C.:

To-day's New York press dispatch states that the professionals are still selling short. I am satisfied that 99 per cent of the American people feel that this outrageous destruction of the small investors has gone far enough and that immediate steps are needed to save the Nation from the disastrous conditions that are bound to follow. It is the consensus of opinion of well-informed men that you, Mr. President, should call upon the financiers of this Nation to stop profiteering and formulate and carry out a plan to save the Nation from dire calamity.

A. J. SABATH.

THE BOARD OF GOVERNORS, CHICAGO, ILL., *November 12, 1929.*
The New York Stock Exchange,
New York City, N. Y.:

To-day's New York press dispatches state that short selling is increasing. In view of conditions I express the opinion of many well-informed men that the board having power to stop all short selling should do so immediately, since the existing dangerous conditions demand such a step and may be helpful and beneficial to the entire Nation. Failure of the board to act may bring about conditions the seriousness of which no one can foretell and for which the board will be held responsible.

A. J. SABATH.

CHICAGO, ILL., *November 14, 1929.*

BOARD OF GOVERNORS,
New York Stock Exchange,
New York, N. Y.

Though I have not been favored with a reply to my wire, I notice that you have issued an order for a questionnaire on borrowed stocks. I feel that conditions demand that you go still further and order that all short contracts should be liquidated and no further short commitments made until ruled by you. I reassert that grave responsibility rests upon you at the present time and your actions will reflect either favorably or unfavorably upon your exchange. No doubt you realize that bona fide investors must be protected.

A. J. SABATH.

Hon. A. J. SABATH,
Chicago, Ill.:

Your telegram addressed to the board of governors of the New York Stock Exchange was received Wednesday morning and referred to me. The business-conduct committee of the exchange had already directed all members to report their position in borrowed and loaned stocks for the purpose of determining the extent of any short interest which might exist in the market. This action was

taken because of persistent rumors that there had been a great deal of short selling, although there was no evidence before the committees of the exchange of the truth of such rumors.

RICHARD WHITNEY, *Vice President.*

At that time the officials claimed that they did not know of any short selling, but later on I will be able to show that the professional short selling began early in the fall of 1929, when all of the insiders, namely, the officials and directors of large corporations, who were aware of real conditions, were selling "against the box." There is no question that thousands upon thousands of shares were sold in this obviously unfair and unjust manner.

Now, to my mind the action of these officials and directors was not only unfair and unjust but criminal; it was like playing with the working people, who were asked to invest and did invest their funds, with loaded dice.

And they had the President and Mr. Mellon and others tell the people to come in and buy stocks—that stocks were cheap and would go higher; that is, while they themselves were selling—thus obtaining money from millions of American citizens under false pretenses. And I am satisfied that if these individuals were brought before any unbiased judge and this evidence submitted, the court would be obliged to find them guilty of a crime. Why, we convict people every day for obtaining a few hundred dollars on false pretenses. But here we have thousands of cases where the American people have been mulcted out of billions of billions of dollars, and no one has been convicted.

Now, the fact is, Mr. Chairman and gentlemen, that I have continued to harass the stock exchange officials and Mr. Whitney with my telegrams and letters. And I have appealed to the President, and, in fact, everyone who I thought would help me stop this abuse, including the Postmaster General and the Attorney General. I am going to ask leave at this time to insert these telegrams and letters in the record so that in the future the country and the people will know what efforts I have made to put a stop to this abuse.

Mr. MCKEOWN. Those will be admitted in the record.

(The telegrams and letters referred to and subsequently submitted by Mr. Sabath are as follows:)

CHICAGO, ILL., *December 23, 1929.*

Mr. E. H. H. SIMMONS,
President (and also to board of governors), New York Stock Exchange:

Immediately after the issuance of the questionnaire by you as to borrowings and loanings of stock the large short selling ceased and conditions improved until the questionnaire was withdrawn. Last week's reports again indicate tremendous short selling. Your statistics show that less than 3 per cent of listed securities are carried in brokers' loans. Surely the owners of 97 per cent of listed stocks should not be at the mercy of a small coterie of destructive shorts and are entitled to your protection. Hundreds of bankers and thousands upon thousands of investors are appealing to me and looking to you to stop short sales or at least to again issue the questionnaire and give publicity to the short selling. Action should be taken by you immediately to give some relief to the millions of stockholders and check these ruinous activities until at least normalcy is restored, as every effort is being made by Washington and everyone else to stabilize conditions and restore confidence. Unless some action is taken by you I shall give full publicity to this request and demand that President Hoover take action and the Attorney General proceed against the pools.

A. J. SABATH.

NEW YORK STOCK EXCHANGE,
New York, December 27, 1929.

Hon. A. J. SABATH,
House of Representatives, Washington, D. C.

MY DEAR MR. SABATH: Your telegram of December 23 was duly received, and I have considered its contents with great care.

As you are aware, the exchange under date of November 12 required reports of all its members as to the borrowing and lending of securities and their position in regard to fail-to-deliver and fail-to-receive items. This questionnaire was continued for several days, but after the answers to the first set of questionnaires had been examined it became evident that the volume of short selling was so very small that it could have no possible effect upon the market, and the questionnaire was therefore discontinued. As revealed by an analysis of the questionnaire of the total short position in all listed stocks as of the 12th of November, which, of course, includes not only the short sales made on that day but all open short sales irrespective of when the sale itself was made, shows that the short position, as compared with the total number of listed shares, was only about fifteen one-hundredths of 1 per cent. The market value of this short position on the same date, as compared with the market value of the listed shares on November 1, which was the nearest comparable date for which the exchange had the data, shows that this short position was about twelve one-hundredths of 1 per cent.

In your telegram you ask that the exchange should again require its members to answer a questionnaire in regard to short sales and that it should give publicity as to who are the short sellers, and you imply that it is the activity of a small coterie of destructive shorts that has caused the recent declines in the stock market. In this I can not agree with you. The evidence as shown by the questionnaire of November 12, and subsequent days, discloses such a ridiculously small short position that the sales made by the short sellers could have little or no effect upon the market. While there have been many rumors attributing to short sellers the recent declines in the market, the exchange has no evidence that the volume of short selling has greatly increased, and it is difficult to believe that there has been any great volume of short selling.

It is, of course, impossible to determine accurately just what causes securities to advance or decline, but it is fair to assume that certain known factors have played a part in the recent movement of prices. The income tax laws of the United States and of the State of New York require individuals who report their income on a cash-received basis to realize losses before those losses can be deducted from taxable income. For many years when securities have declined in value heavy selling has taken place in the latter part of December, and it has always been assumed that this volume of sales was the result of the rule requiring individuals to register their losses for income-tax purposes. Furthermore, our income tax laws provide that a loss can not be deducted if the taxpayer repurchases the same or similar securities within a period of 30 days. As a result of these two rules, many individuals sell in order to record a tax loss and keep their money available so as to be able to repurchase the same security as soon as the 30-day period has expired. It is fair to assume, at the close of a year in which security prices at first advanced and then declined very rapidly, that many individuals who had recorded profits in the earlier part of the year were anxious to record their corresponding losses which had accrued in the latter part of the year. This tax selling has, in my opinion, been one of the important factors in the weakness of the market during the last two weeks.

Another known factor is the desire of the officers and directors of corporations to prepare for the annual statement which, in most instances, reflects the condition of the company as of the close of the calendar year. Many corporations, and particularly investment trusts, which were carrying substantial amounts of securities for investment, have thought it wise to sell some of their securities so that their balance sheet on December 31 would contain a reasonable proportion of cash or liquid investments. This practice of corporations preparing for their annual statement to stockholders is a common one and is employed not only by railroad and industrial corporations but also by many national and State banks. Economists have long noticed this tendency as it is reflected in the periodic increase in interest rates at the turn in each year.

Another known factor has been the lack of buying by the public in general. This was a natural consequence of the very severe declines in security prices in the end of October and the early part of November of this year. Such readjustments in security prices always make investors hesitant to buy securities until the definite trend of the market has been established. This hesitancy on the part of investors, coupled with the liquidation which has been caused by selling for income-tax purposes, or selling for the purpose of readjusting the balance sheets of corporations, has accentuated the downward trend of prices during the past two or three weeks, and since there is nothing to indicate to the exchange the existence of any large amount of organized selling it is confident that whatever short selling has taken place has had practically no effect upon the market.

In conclusion, let me state that the officers and governors of the exchange are, as they always have been, in constant touch with the market and are giving daily consideration to the problems of said conditions created by the course of prices on the exchange. In so doing, the officers and governors of the exchange recognize the responsibility which rests upon them of constantly safeguarding the investors in the securities dealt in on the exchange and in protecting said investors from unfair and unethical practices.

Yours very truly,

E. H. H. SIMMONS, *President.*

CHICAGO, ILL., *December 26, 1929.*

His Excellency HERBERT HOOVER,
President of the United States,
Washington, D. C.

For the purpose of restoring confidence and stabilizing business, industrial leaders of the United States have pledged themselves to cooperate; but a small coterie of gamblers wilfully and deliberately, through short-sale manipulations, are not only undoing your constructive efforts but are further demoralizing business and general conditions. The exchanges which have it in their power to stop this destruction by stopping the tremendous short selling are indifferent to your efforts and the welfare of the country. In order to bring about your aims, I feel you should demand cessation of these purely gambling ruinous activities of the destructive forces. The large number of genuine investors of this country who own more than 90 per cent of its securities outright can demand that their values are protected against vicious manipulation and that their peace of mind is protected so that they may continue their work unharassed.

A. J. SABATH.

CHICAGO, ILL., *December 26, 1929.*

Hon. WILLIAM DE WITT MITCHELL,
Attorney General of the United States,
Washington, D. C.

The President and everyone connected with the administration and the leaders of industry are endeavoring to restore confidence and bring about normal conditions, but a few New York bears are bringing about greater destruction by selling thousands upon thousands of shares which they do not own, thereby vitiating the efforts of all who have pledged themselves to stabilize conditions. It is my opinion that you should investigate whether these manipulators are organized in any way and that you should consider whether they can not be proceeded against for conspiracy, as they are using the mails and interstate means of communication in their activities.

A. J. SABATH.

CHICAGO, ILLINOIS, *October 11, 1930.*

BOARD OF GOVERNORS,
New York Stock Exchange,
New York, N. Y.

GENTLEMEN: A year ago, before the crash, I wired you that in the interests of the Nation all short selling should be discontinued. A few days later you issued a questionnaire to your members as to the loanings and borrowings of

stock and market conditions improved. But within a few weeks you withdrew the questionnaire, with the result that another wave of short selling ensued, and is still continuing to the detriment of the entire country.

I have tried in every way by congressional action and through the administration to put a stop to the destructive practice of short selling but failed to obtain any cooperation at that time. You have permitted, sanctioned, and even approved of this infamous practice. Therefore, I view with some degree of satisfaction the report in to-day's newspapers that you have declared war on the "bears." But instead of war, it is merely an apologetic request upon the organized destroyers of our stability, commerce, and business, to be careful as to their mass and collusive bear raiding.

This, to my mind, will not satisfy the American people. They now demand that not only the concentrated but all short selling cease, if not for all times, at least long enough to give business and industry a chance to recuperate from the nationwide depression and unemployment. I am convinced that this demand will not subside until this destructive practice ceases.

Neither you nor your shrewdest publicists can successfully deny or contradict the fact that these very manipulators in 1927–28 forced the prices of securities to unjustifiable heights and in the latter part of 1929 started the short-selling campaign, utilizing every conceivable rumor to aid them in their treasonable action which has brought about the greatest, most destructive, financial tornado in the history of our land. A storm which wrecked hundreds of banks and financial institutions; closed thousands upon thousands of businesses; destroyed thousands of factories and plants thereby forcing out of employment millions of our citizens and causing untold want and misery.

But this is not all. The life earnings of from ten to twenty millions of citizens were swept away; the very lives of hundreds of men have been taken; thousands have been driven to insanity. All this should and could have been avoided if your exchange and similar institutions had the slightest interest in the country's welfare.

I again call upon you to stop immediately all short selling, if not for the country's sake then do it for your own, as failure on your part to act may eventually stop not only short selling but all gambling transactions on all the stock exchanges and boards of trade.

Very truly yours,

A. J. SABATH.

CHICAGO, ILL., *October 11, 1930.*

Mr. RICHARD S. WHITNEY,
President New York Stock Exchange, New York, N. Y.

DEAR MR. WHITNEY: I read in the press that at a banquet of the Illinois Chamber of Commerce you have sharply criticized the recent proposal for legislation to restrict short selling. As the proponent of this legislation, I honestly and sincerely believe that it is detrimental to legitimate business and responsible for the crash in 1929, and the ever reoccuring breaks as reported by the most reliable financial writers and the press of the country.

You have endeavored to justify short selling by stating "the prohibition of short selling would inevitably result in a stagnant market and then a dangerous inflation, uncontrolled by the brake which short sales provide," and then proceed to state that "we saw last year the disastrous consequences of inflation of security prices."

Surely you nor anyone else can contend that there was any restriction on short selling in the years of 1928 or 1929 and still we had the greatest inflation in the history of the world. Consequently, short selling did not stop inflation. During these years it in no wise stopped the tremendous over-capitalization or issuance of millions of shares of new stocks far above any legitimate requirements of industry but for the mere purpose of unloading same at artificial, fabulous prices made possible by the stock-exchange facilities.

Another glaring inconsistency in your speech is your statement that during the crash there was little short selling and yet no one could say that we had a "stagnant market" which you prophesy as the "inevitable result" of short selling.

I assure you that it is farthest from my thoughts to say or do anything that would hurt the legitimate trade, but I am convinced that short selling brought about the crash which destroyed over $50,000,000 of values, jeopardized the credits, and thereby the legitimate commerce of the Nation, and also destroyed confidence in business and increased unemployment.

I have been reassured in my conviction that short selling is destructive by the fact that when on November 12, 1929, you issued a questionnaire as to loanings and borrowings of stock, the market started to right itself while same was outstanding and short selling had ceased for a brief time.

Furthermore, if I am so wrong and short selling is right, why did you, only a few days ago, issue a warning against "mass short selling"? I again wish to assure you that I recognize the need of an institution for the sale of securities, but on the other hand in view of the thousands of communications I have received from students and experienced economists I am just as firmly convinced that short selling can not be successfully defended from any point of view, except that it produces more business for the exchanges.

In view of these facts, I feel that all of the stock exchanges can and should cooperate with the press and the men of this Nation who are desirous of restoring confidence in business and prosperity by at least suspending during the present emergency this undefendable, purely gambling policy of short selling.

Yours very truly,

A. J. SABATH.

NEW YORK STOCK EXCHANGE,
New York, October 22, 1930.

Hon. A. J. SABATH,
Member of Congress, House of Representatives,
Washington, D. C.

MY DEAR MR. SABATH: I have your letter of October 11, in which you state that you have read the press reports in regard to the address which I delivered on October 10 before the Illinois Chamber of Commerce. After reading your letter carefully I feel that the press reports fail to convey the real substance of my speech and I, therefore, inclose a copy of it. You will find, particularly on pages 12, 13, and 14, a statement of my position in regard to the necessity of short selling and the reasons why I am convinced that the prohibition of short selling will only tend to produce artificial results. You will also find that the exchange did not issue a warning against "mass short selling." It did call attention to the provisions of section 4 of article XVII of the constitution, which forbids the purchase or sale of securities for the purpose of upsetting the equilibrium of the market or bringing about a condition of demoralization in which prices will not fairly reflect market values.

As to cooperating with the people who are desirous of restoring confidence in business, I assure you that there is nothing that we are more anxious to do, but we are unwilling to do away with normal short selling which we consider essential to the stability of the market as that would create an artificial situation which, in the long run, can only produce dangerous results.

Faithfully yours,

RICHARD WHITNEY, *President.*

CHICAGO, ILL., *October 16, 1930.*

His Excellency HERBERT HOOVER,
President of the United States, Washington, D. C.

DEAR MR. PRESIDENT: A year ago, before the crash, I called your attention to the approaching alarming conditions and advocated and pleaded for a cessation of the disastrous, pool, short-selling practice.

Therefore, I read with some satisfaction in to-day's press of a conference you held with the New York Stock Exchange officials regarding short selling and the investigation of stock-exchange transactions by the Department of Justice. The report indicates that they question the Government's power to stop this prosperity-destroying practice.

No one can successfully deny to-day that the stock crash, to which you alluded in your December message, was responsible for and aggravated the conditions that have brought about the wrecking of hundreds of banks and financial institutions, the closing of thousands upon thousands of businesses, the destruction of thousands of factories and plants, thereby forcing out of employment millions of our citizens and causing untold want and misery.

It is known to be a fact that the New York Stock Exchange can curb short selling by the issuance of an order that all loanings and borrowings of stocks

cease. This will bring short selling to a minimum. If the stock exchanges have any interest in the welfare of the Nation and in the reestablishment of confidence, they will, if not for the country's sake, then for their own sake, issue immediately such an order without questioning the power of the Government to stop this nefarious practice.

This in a great measure will eliminate uncertainty and will have a tendency to reestablish confidence, which is so sadly needed, for the resumption of the legitimate business of the country. Please be assured that my activity against these destructive shorts is prompted only by a sincere desire to improve the deplorable conditions of the Nation.

Permit me to remain,

Respectfully,

A. J. SABATH.

THE WHITE HOUSE,
Washington, October 17, 1930.

Hon. A. J. SABATH,
House of Representatives, Washington, D. C.

MY DEAR MR. SABATH: Your letter of October 16 has been received and will be brought to the attention of the President.

Sincerely yours,

LAWRENCE RICHEY,
Secretary to the President.

CHICAGO, ILL., *June 10, 1931.*

BOARD OF GOVERNORS,
New York Stock Exchange, New York, N. Y.:

Notwithstanding your questionnaire on borrowed stocks, the newspapers continue to call attention to the bear raids which are causing continuous uncertainty and fear and are making impossible reestablishment of confidence; therefore I again urge in the interests of the Nation as well as of your institution to stop all short selling, as the situation is serious and you should do your part to relieve conditions.

A. J. SABATH.

NEW YORK STOCK EXCHANGE,
New York, June 11, 1931.

Hon. A. J. SABATH,
Member of Congress, House of Representatives, Washington, D. C.

MY DEAR MR. SABATH: I beg to acknowledge your wire of June 10 in which you refer to the recent questionnaire sent out by the exchange and also to the matter of short selling. I regret to advise that I do not agree with the fundamental position you take that short selling has caused the business depression that has existed.

Particular aspects of short selling usually involve the whole subject, which is too complex to discuss easily in a single letter. The short selling of securities finds a counterpart in the "forward sales" or "sales for future delivery," which exist throughout business. If the practice of selling something which one does not own at the time, but which one can readily obtain later on, is to be held illegitimate, per se, it would not be sufficient to change a few stock-exchange rules. We should have to revolutionize the financial, commercial, and industrial laws and practices of the whole country.

The rôle of the short seller as a cause of declining security prices is usually exaggerated in bear markets. The actual cause of declining prices is a general wish on the part of security holders to sell, coupled with a general unwillingness on the part of investors and speculators to buy. The principal result of short selling is to hasten a price decline inevitable for other reasons.

The stock exchange is, of course, a market, and it must reflect with equal readiness the optimism or the pessimism of the security-buying public. It is not the function of the stock exchange to put the price of securities up or down, or to attempt to interfere artificially with the operations of the law of supply and demand. In the long run the stock exchange does not possess the power

to prevent the price of securities declining if the public is unwilling to buy them. For the stock exchange to attempt to manipulate prices by making it easier to buy than to sell, or to sell than to buy, would be a perversion of its true functions.

The owner of securities should not in his own interest disregard the very real services which the short seller performs for him. In the first place, as far as short selling acts as a brake on price inflation, the investor is prevented from purchasing stocks at exaggerated prices and later on incurring losses upon them. It was largely because of the insufficient amount of short selling in the summer of 1929 that the subsequent decline in stock prices proved so sharp. Certainly if we are to lessen share inflation in the future the abolition or curtailment of short selling is not the way to do it.

On the other hand, short sellers become by that very act the only compulsory buyers of stock. When prices are falling, outright investors usually wait until the decline has spent its force before buying, while margin purchasers, even if willing to purchase more stock, are often prevented from doing so by losses imposed on them by the decline. Covering by the short interest, therefore, often represents the only important immediate buying power in the market. Many people seem to forget that it is impossible to sell stock on the stock exchange or anywhere else unless someone is willing to buy it. To prohibit or artificially curtail short selling would only render the market more liable to severe price declines when, owing to the lack of a short interest, stocks would be temporarily unsalable and their fluctions would be very violent. This is one reason why all the great stock exchanges of the world have always permitted short selling, and why the numerous attempts in all leading countries over the past century to abolish short selling have always produced such serious trouble that, without exception, they have been abandoned.

All this has, of course, been said many times before. Unfortunately, the man who owns securities and sees their quotations steadily falling is only too apt to look for some kind of relief through new stock-exchange regulations. Sometimes his losses cause him to be so worried that he will advocate measures which are not economic and which strike at his own permanent self-interest as an investor. The New York Stock Exchange has attempted to safeguard the process of security investment for many years and in a great variety of ways. It has every selfish reason for continuing such a policy. It realizes perfectly that its own activities and the business of its members directly depend on the security-buying public. But the stock exchange has no remedies at its disposal to repeal the law of supply and demand or to prevent the fundamental movements in security prices which arise from it and which reflect basic economic conditions throughout the country.

I tremendously appreciate your interest and your trouble in sending me your wire. I only trust that what I have written above clearly sets forth to you the fundamentals of this question as we see it.

Faithfully yours,

RICHARD WHITNEY,
President.

CHICAGO, ILL., *September 23, 1931.*

To His Excellency HERBERT HOOVER,
President of the United States, Washington, D. C.

MY DEAR MR. PRESIDENT: I again take the liberty of asking that the governmental facilities be prohibited to the unlawful and criminal activities on the part of the professional short sellers who, beyond any doubt, are responsible for the great panic. No evidence of my position is necessary other than the statement on short selling of Mr. Whitney, president of the New York Stock Exchange, made the day before yesterday:

"During the present emergency it would tend to bring about a condition of demoralization in which prices would not fairly reflect market values."

I feel that it has been clearly demonstrated that if short selling ceases confidence can and will be restored and business resumed. I repeat, the Government has the power to stop this unlawful—yes, criminal—gambling practice.

Yours very respectfully,

A. J. SABATH.

THE WHITE HOUSE,
Washington, September 25, 1931.

Hon. A. J. SABATH,
Chicago, Ill.

MY DEAR MR. SABATH: Your letter of September 23 has been received and I have placed it before the President. He has read it with interest.

Sincerely yours,

LAWRENCE RICHEY,
Secretary to the President.

Chicago, Ill., September 23, 1931.

Mr. RICHARD WHITNEY,
President, New York Stock Exchange, New York, N. Y.

DEAR MR. WHITNEY: I was ready to congratulate you on your splendid and straightforward statement regarding short selling made on last Monday but I read to-day that the order banning short selling has already been rescinded.

In view of what you yourself have said about the demoralizing effect of this practice, I can not conceive of any reason for this rescinding order.

For two years I have appealed to your patriotism and good citizenship to stem the growing depression by using your efforts to stop the destructive practice of selling short. Your statement and the 2-day ban helped considerably, the market reacted favorably and saved the situation when Great Britain suspended the gold standard.

I believe that a continuance of the restriction of short selling will be a great factor in helping to reestablish confidence in the people and in the restoration of business, and I hope that you and the governors of the exchange will see your duty clear to again ask your members to refuse to accept short-sale orders, thereby helping the entire Nation.

It is within your power to do this, and by so doing you can forestall legislation that will go way beyond the prohibition of short selling.

Very truly yours,

A. J. SABATH.

NEW YORK STOCK EXCHANGE,
New York, October, 5, 1931.

Hon. A. J. SABATH,
House of Representatives, Washington, D. C.

MY DEAR CONGRESSMAN SABATH: I am very appreciative of your trouble in writing me your letter of September 23. I am afraid you have entirely misunderstood me.

I have never stated that legitimate short selling had a demoralizing effect. I have stated that illegitimate short selling, what is known as bear raiding, tends to demoralize the market. This latter we have done everything in our power to prevent. The short position in the market of late has very materially decreased in the past few months, and particularly in the last two weeks, and has therefore served tremendously as a purchasing power in the market during this period.

I am inclosing herewith, for your information, a copy of the notice I gave to the press on September 23, in which it was frankly stated why we had rescinded the ban on short selling.

I am planning to make an exhaustive statement on this whole subject on October 16 and shall be happy to send you a copy of what I have to say at that time. I wish it were possible to have a talk with you personally on this whole subject, which would be so much more satisfactory than writing. If we continue to disagree on the fundamentals, we could at least chat about horses, which I believe we are both much interested in. In any event, let me express my appreciation and thanks for your letter, and I do hope it may be possible to see you personally some time in the future and talk this subject over with you in detail.

Faithfully yours,

RICHARD WHITNEY, *President.*

CHICAGO, ILL., *October 5, 1931.*

MR. RICHARD WHITNEY,
President of the New York Exchange,
New York City.

DEAR SIR: More than two years ago—even before the stock-market crash—I had appealed, supplicated, and finally demanded that short selling, and particularly professional short selling, be stopped, having felt at the time that unscrupulous gamblers would take advantage of the then impending depression. I pointed out that in order to save the Nation from financial chaos and misery it was absolutely imperative to prevent, or at least restrict, short selling, for tremendous short selling was bound to effect not only stocks but bonds also, and thus impair the position of most of our banks which held much of these securities as collateral.

These appeals I have reiterated on various occasions since then, but to all of my appeals you either have turned a deaf ear or have attempted to defend short selling as a necessary "brake" on "dangerous inflation." Yet during the period of extreme inflation, from 1925 to 1929, inclusive, short selling as a "brake" was of little or no consequence.

To be fair, I must concede that on November 12, 1929, or thereabouts, you did send out a questionnaire to the members of the exchange regarding the scope and extent of the short interest, though it is my recollection that the questionnaire, probably because it centered hostile attention on the large short sellers, had a very favorable effect on the market, which changed for the worse again almost as soon as the questionnaire was withdrawn. I must concede, also, that you did request, on the day preceding Britain's obolition of the gold standard, that short selling should cease temporarily; though the result was as I expected—the market reacted favorably, notwithstanding disquieting news from London. In both instances it was obvious to me that when short selling was prohibited the market seemed to adjust itself favorably.

In view of the alarming conditions, I feel it is imperative that short selling should cease immediately. The extreme inflation and the present deflation caused by professional short selling is responsible for the closing of 2,000 banks, has thrown more than 8,000,000 people out of employment, has sent thousands of business men into bankruptcy, and has brought misery and dissatisfaction to the entire Nation.

When I began my crusade against unmitigated "bear" operations two years ago, a majority of the financial publicists and economists, influenced by the avaricious professional short sellers, retarded my efforts. To-day, however, not only enlightened economists and unsubserviant newspapers, but that same apathetic group are beginning to realize the destruction that has been done. There is no question that the matter of the prohibition of short selling will be taken up in the next session of Congress.

Before Congress convenes, however, I am hoping that you will see the justice and righteousness of my position and restrict short selling of your own volition. Failure on your part to heed my warning to stop short selling may result in a demand to suspend all trading on the stock exchange until strict regulatory laws are enacted.

Very truly yours,

A. J. SABATH.

CHICAGO, ILL., *December 1, 1931.*

MR. RICHARD WHITNEY,
President New York Stock Exchange, New York City, N. Y.:

The current issue of Barron's states: "Meantime short selling has lost none of its vogue with the rank and file. The practice is general on all sides, so easy and so prompt have been the results." Wall Street tipster services disseminated by the vast majority of the brokerage houses throughout the United States in the interests of the shorts are endeavoring to create fear in the minds of the people against the approaching session of Congress; all with the deliberate intent to destroy whatever confidence there still remains. By immediately prohibiting short selling you can easily put an end to this vicious destructive propaganda and save the Nation, as well as your own institution, from complete demoralization. This action is absolutely necessary, inasmuch as your so-called restrictive measures have signally failed, as is stated by the best informed authorities on Wall Street.

A. J. SABATH.

Mr. SABATH. Thus it can be readily seen that I have done everything humanly possible to make the stock exchange officials and the administration realize the destructiveness of short selling and the need for prohibiting it, at least, until conditions return to normal.

Now, Mr. Chairman and gentlemen, I shall try to bring home to your minds these vicious practices, as I view them, as well as I can; and I hope you will bear with me. I have been a little nervous in the last few days.

Mr. MCKEOWN. Yes; we all sympathize with you in your recent affliction, Mr. Sabath.

Mr. SABATH. Thank you.

At the beginning all I received for my efforts in annoying them with those communications were condemnatory letters, mostly emanating from the offices of the brokers on Wall Street and LaSalle Street.

But, finally, Mr. Whitney realized that the people were commencing to take notice; and he started in 1930 to defend his position. His first speech in defense of short selling was delivered in my city [Chicago] on October 10, 1930, just about a year after I started my crusade. The next one he delivered at the Hotel Astor on September 17, 1931; the third at Hartford, Conn., on October 16, 1931; and the last on December 15, 1931.

Mr. LAGUARDIA. That was at Syracuse, was it not?

Mr. SABATH. That was at Syracuse. All of these speeches were broadcast over the radio, and every stockbroker was requested to listen in, and in addition, every investment house received a special communication from Mr. Whitney informing it that copies of the speeches would be forthcoming and asking that it make a general distribution of these speeches to all customers and board-room habitués.

Mr. CONDON. Of course, you do not condemn him for that, do you? He had a perfect right to make out his own case, did he not?

Mr. SABATH. No; I do not. But what I say is that he appeared here a few days ago, directly and indirectly defending the practice of short selling.

Mr. LAGUARDIA. And doing more than that, Mr. Sabath; not only defending it, but justifying it, and urging it as a necessity for the accomplishment of business.

Mr. SABATH. Yes; and he and the professors who have been sent down here by the stock exchange, notwithstanding the fact that they did not expressly say so——

Mr. CONDON (interposing). Well, Professor Lawrence did.

Mr. LAGUARDIA. And so did the other gentleman.

Mr. SABATH. Yes; perhaps so. In response to my inquiry addressed to the Wharton School of Finance and Commerce of the University of Pennsylvania as to whether or not Professor Huebner really represented the university, as he originally stated when he

was here, and as I expected, I received the following letter from the lean:

UNIVERSITY OF PENNSYLVANIA,
Philadelphia, February 20, 1932.

Mr. A. J. SABATH,
House of Representatives, Congress of the United States,
Washington, D. C.

MY DEAR MR. SABATH: Your inquiry of the 19th instant has been received. As stated in the press, Prof. S. S. Huebner appeared before the Judiciary Committee of the House of Representatives on behalf of the Stock Exchange of New York. He had not been delegated to speak for the university.

Sincerely yours,

EMORY R. JOHNSON.

Mr. LAGUARDIA. Well, I think in fairness to Professor Huebner, Mr. Sabath, it should be made clear that he said he was of the faculty there; and I asked him if he was a consultant, and he said, yes; he was a consultant; and I asked him if the stock exchange has asked him to come here, and he said, yes. Is that not so?

Mr. CONDON. Yes.

Mr. SABATH. Well, I was not present.

Mr. LAGUARDIA. There is no doubt that he came here in a professional capacity.

Mr. SABATH. That is all right. I was not present when you asked him those questions.

Now, Mr. Whitney and these experts lay great stress upon the fact that this practice is permissible and that it is legal. I concede that where there is delivery some of the courts have held that it is legal. But in all instances where there is no intent of delivery the courts have criticized it and have declared it to be pure gambling. In this connection, I have several cases here which I wish to embody in the hearings, though I wish I had the time to read the severe criticisms made by some of the judges. I am embodying these cases, and there are three or four of them, merely to offset the statements which have been made that all courts have declared that short selling is legal and valid and that they have looked upon it with favor.

(The citation of cases reads as follows:)

A short sale is not per se illegal as a gambling transaction: Boyle *v.* Henning (121 Fed. 376), Appleman *v.* Fisher (34 Md. 540), In re Taylor (192 Pa. 304).

However, such a transaction is illegal if an actual sale is not contemplated and the real intent is to speculate in the rise and fall of prices: Riordon *v.* McCabe (341 Ill. 506), Hurd *v.* Taylor (181 N. Y. 231).

The case of Riordon *v.* McCabe, supra, recently decided by the Illinois Supreme Court, would, in the light of the transactions held on the Chicago Board of Trade, make a great part of them mere gambling, being, in fact, bets and not contemplating the delivery of any property of any kind.

Another important case on this subject decided by the Supreme Court of the United States (Clews *v.* Jamieson, 182 U. S. 461) reads in part as follows:

"If, however, under the guise of a contract of sale the real intent and purpose of both parties is to speculate in the rise and fall of prices and the property is not to be delivered at the time fixed for delivery and one party is to pay the other the difference between the contract price and the market price, the whole transaction must be considered as a wager and invalid."

The reason for this rule is well stated by an early case (Melchert *v.* American Tel. Co., 11 Fed. 193) in one of the district courts of the United States:

"Such a dealing amounts to a mere speculation upon the rise and fall of prices. It required no capital except the small sums demanded to put up margins and pay differences. It promotes no legitimate trade. Any impecunious gambler can engage in it with infinite detriment to the bona fide dealer. It enables mere adventurers at small risk to agitate the markets, stimulate and depress prices, and bring down financial ruin upon the heads of the unwary, * * *. Black Fridays are its legitimate progeny."

Other cases might be cited, all to the same effect. A case, Hurd *v.* Taylor (181 N. Y. 231), which may be said to be the leading case in that State, clearly holds that a so-called short sale may be conducted on the exchange the same as any other sale; but there is this well-understood rule that is found in this case and every other case which approves the short sale, that there must be a delivery of the stock. If the delivery is not made and such is not in contemplation by the parties, then the transaction is a wager. If it is understood that the broker keeps the stock so purchased in his name and never places it in the name of the customer and deals with it as if it were his property and keeps the gains and losses in a set of books which are the final basis of settlement, and the parties do not have in mind to do anything other than pay in cash the difference at the end, which in truth describes thousands of accounts, then such dealings do not come within the approved rule of short selling of any court of any State, but are described in all the cases as gambling.

Mr. LAGUARDIA. Mr. Sabath, only yesterday our colleague from New York, Mr. Oliver, put in the record a decision rendered by the Supreme Court of the State of New York in the latter part of February—after Mr. Whitney had testified before this committee—characterizing these practices as to short selling——

Mr. SABATH (interposing). I can not see how any honest judge or court can rule that it is legal or valid. Why, any rational person knows that short selling is nothing but pure gambling.

Mr. OLIVER. Judge Sabath, would you prefer to have us ask you questions as you go along, or would you prefer to go ahead with your statement uninterrupted?

Mr. SABATH. Well, I am trying to answer their defense first.

Mr. OLIVER. Then I do not want to disturb you; you may proceed.

Mr. SABATH. And when I get through with that, I shall be glad to answer questions.

You have heard them say so often that short selling "acts as a cushion." The trouble with us is that so many Members of the House are so busily engaged with their manifold duties that they are misled about these things.

Mr. Whitney, able man that he undoubtedly is, must hold the members of this committee and the people of the Nation in contempt by submitting figures purporting to show that the total short interest at any one time was insignificant when compared with the total amount of shares outstanding and by expecting them to draw the only inference—that short selling is of no consequence. I believe he said that at the height of the panic the ratio between the amount of shares sold short and the total amount listed was about one-eighth of 1 per cent. But why Mr. Whitney has chosen to compare the number of shares sold short with the total amount is indeed difficult to understand. Certainly it would be more a manifestation of common sense to compare the total short sales with the floating supply, or, of infinitely greater value and import, the total short sales with the total long sales on any given day. And again, assuming that only 4,000,000 shares had been sold short at any given time,

certainly it is plain that the short sellers would not be so foolish as to spread their shot over the entire list of securities, many of which are seldom traded in during the year. The truth is that "bull" and "bear" operations are concentrated on a few pivotal and volatile securities which are pushed up and down at will. The rest follow naturally enough.

Every short sale is made with the deliberate intent of destroying whatever commodity or stock that the short seller may sell. A short seller is not a producer. A short seller is a destructive individual; he is trying to destroy a thing that another man owns or produces. And I can hardly grasp the thought that we should have permitted such practices for so many years.

Mr. CONDON. May I ask you a question there?

Mr. SABATH. Yes.

Mr. CONDON. In that connection, may not the reason for it be this, that the short seller is trying to get stocks back to a value which he considers is fair, rather than the inflated values that he finds those particular stocks have when he starts his operations? In other words, is he not using his judgment as to what should be the true value of the stock? That is a question that I should like to have you answer.

Mr. SABATH. No short seller ever has the interest of a particular commodity or stock in mind. His mind is occupied with the question, How much money can I make on that particular deal? His aim is to make money; do you understand?

Mr. CONDON. Yes; but——

Mr. SABATH (interposing). And he sells short, not to equalize the prices, not to adjust the conditions, but to make money.

Mr. CONDON. May I suggest that that is the motive of all men of business—to make money and as much as they can?

Mr. SABATH. This is not business, but a destructive practice; because anyone, any child, any fool can destroy; but it takes a man of ability to help to build up, to erect a structure.

Mr. CONDON. Well, what do you think of the men who build up to such inflated values that many fools rush in to try to get some of that "easy money"?

Mr. SABATH. Now, you have asked me something that I am mighty pleased to answer. I have no excuse for, and am ready to condemn, these men who willfully and deliberately inflated values of the stocks and concede that they are just as guilty—in fact, they made possible the evil practices of these men to-day. But permit me to say that they are the same men who to-day one will find selling short; that they were the "bulls" in 1928 and 1929; and that they were bankers and officers of banks and corporations. They are men who stand high in our communities. They go to church on Sundays and give little donations here and there to the poor. They are the men who have accumulated millions upon millions of dollars at the expense of thousands of widows and dependents who are to-day homeless and penniless.

I say that those men who caused the criminal inflation and who are destroying to-day should be publicly censured and restricted in

their activities. And I am trying, if in any way possible, to restrain them in their infamous operations.

Mr. CONDON. And that, you say, includes short selling and alsc selling long on the market?

Mr. SABATH. All professional manipulation, gambling, and pool action.

Mr. CONDON. Then the operations of all kinds on the stock exchange ought to be forbidden?

Mr. SABATH. No. I am not opposed to legitimate sales, and there is no question that a great number of the sales made are legitimate. But is it necessary to sell a certain stock ten times every month, or three times a day? Is it necessary to turn over the total stock issued by a company every four days—as was the case in the J. I. Case stock in 1931? That is gambling. I do not object to a legitimate stock exchange or market place; but do we need to have three or four or five million shares, or ten million shares, of stock sold in a day? That is a professional market.

I want a man who owns stock to have a chance and an opportunity to sell it at the market—not an artificial and criminally manipulated market, but a legitimate market.

Now, I have something here that might interest you in connection with that; and I ask you whether you think it is necessary to sell millions of shares of stock every day to create a legitimate market?

I have here a statement from a gentleman named A. V. Shaw; he states:

> The entire common capitalization of a well-known company listed on the New York Stock Exchange was sold 94 times on the stock exchange in two years, in 1930 and 1931. The commissions alone on this turnover amounted to over $8,000,000, or more than the entire issue was worth at the close of 1931.

Now, do you think these were all legitimate sales? No one is gullible enough to believe that they were. This was a clear-cut case of gambling, nothing else but dishonest gambling. And that, gentlemen, is what I am trying to stop.

I will tell you why these gentlemen of the stock exchange are so much interested in maintaining a free and open market, as they choose to call it. It is not so much because they are interested in providing a ready market for securities, as Mr. Whitney would have you believe, but rather because they are interested in continuing the activity that such a market represents. A free and open market means activity and activity means business in the form of commissions and loans. Do you know that in 1929 the brokers' commissions and interest charges on loans amounted to $959,000,000? That sum, I believe, speaks for itself, and no expression of solicitude for the customer by Mr. Whitney or the gentlemen sent here by the exchange can efface the significance of this figure.

Mr. YATES. What year was that, Mr. Sabath?

Mr. SABATH. 1929. Now, permit me to insert here the number of shares listed, the market value of them, the percentages and the cost of operation. These figures were not compiled by me, but by Mr. E. C. Riegel of New York.

The statement referred to was subsequently submitted by Mr. Sabath and is as follows:

New York Stock Exchange record 1929

Number of shares listed		942,492,072
Sales of shares		1,124,608,910
Market value of sales		112,460,691,000
Brokers' loans (average constant)		6,000,000,000
Commissions to brokers on stocks	$449,843,564	
Commissions to brokers on bonds	7,550,790	
United States and New York revenue charges	44,984,356	
Interest charges (average 7.62 per cent)	457,200,000	
Total brokers' charges to customers		959,578,710
Dividend yield on all listed shares (average 3¼ per cent)		3,654,978,957
		Per cent
Brokers' charges on stocks (compared to market price)		0.85
Ratio of brokers' charges to dividend income		26.00
Net dividend return		2.40

The above figures are not absolute but are approximately correct and reveal a picture the stock exchange does not care to have revealed. It shows that by pyramiding prices and charges the stockholders' income during the boom was reduced to the small percentage of 2.40 or about one-third of what it is now during depression. Of course, the stockholder who did not "trade" did not suffer from this shaving process. On the other hand, a man who ran a "trading" account of about $1,000 per week with a weekly turnover, paid 52 times 0.85 per cent or 44.20 per cent of his capital. With this sort of capital bleeding it is obvious that listed stocks must sooner or later develop a list and that from an income standpoint, if "traded" in upon the exchange, are a very poor buy. What the scalping process of the exchange is worth to the members may be seen from the price of a membership which in 1929 sold as high as $625,000. With 1,100 members at that time the "bookie value" of the New York Stock Exchange was $687,500,000. To-day, with prices down, dividends high, and "trading" small, the racket is valued according to a recent sale of a seat at about 25 per cent of the 1929 value. In other words, the more the stockholder gets for his money the less a seat on the exchange is worth and vice versa.

It is amusing to note how far some gentlemen can go in trying to defend short selling. If my memory serves me, there was Professor Huebner, who said, "Oh, yes; that will prevent a man who is away from his home and owns shares of stock from selling them."

Mr. Chairman, that is not a short sale. I do not object to such a sale. In this case the man owns the stock, and the stock exchange can easily adopt a rule specifying that where a man is away from his place of business or is traveling he can have additional time to deliver such stock. You understand that, I hope. I do not propose to deprive a man so situated of an opportunity to sell, it matters not where he be.

Mr. Whitney and others assert that stock prices are the result pure and simple of the great economic law of supply and demand and that they are an expression rather than a cause of this depression. Permit me to say that I disagree with Mr. Whitney and his gentlemen. In theory the stock prices should reflect the law of supply and demand and should be an effect rather than a cause. Yet a cause they are, for the natural law applies only to a condition where there are no unnatural machinations to interrupt it. Would any person deny that "wash sales," pool operations, misleading financial reports, and the circulation of false statements interfere with the law of supply and demand? I hardly think so.

Mr. Chairman, there was nothing to prevent short selling in 1927, 1928, and 1929. Why did not short selling do then what is claimed

for it now? The answer is simple. The individuals who really determine the trend of the market and who are now "bears" were then "bulls." They were no more interested in equalizing prices or stabilizing the market than they are now as "bears." Ask the small short sellers who in 1928 and early in 1929 sold short in the belief that stock prices were too high—which in fact they were, selling in many instances more than five to ten times their value—what happened when they went against the trend of the market. You will find without a doubt that nearly all of them were thoroughly beaten and cuffed around. Ask them whether their sad experiences have taught them anything. I am confident that they will say, "Do not trade against the trend of the market," or, to put it more correctly, "Do not trade against the trend created by the big operators."

The exchange, says Mr. Whitney, regulates all possible wrongdoing. Of course, it is difficult to understand just exactly what Mr. Whitney means, for he has a delightful way of being ambiguous. Oh, I have no doubt that when there is an apparent irregularity on the part of some member or brokerage house, for example, when some widow is swindled out of a life savings, heroic measures are used to punish the offenders. However, when cases of irregularities or wrongdoing are not so apparent—and I should say that a majority of the irregularities are of this nature—little is heard of punishment meted out, if any at all. Take, for instance, this question of "bear raiding."

In his broadcasts and talk before the committee Mr. Whitney was profuse in his statements that the exchange, while opposed to any restriction on short selling, is doing everything in its power to prevent "bear raiding." Yet during the course of his testimony before the committee, when he was asked how many individuals were punished by the exchange for "bear raiding" in the last two years, he made the startling statement that, although there had been many alleged instances of this practice, the committee on conduct could find no evidence of a single violation of the rules of the exchange in this regard and therefore that no one had been punished.

Frankly, gentlemen, I am more interested in action than I am in profuse expressions of action. But I find it difficult to understand how it is, in the light of what has happened in the last two years, that this committee on conduct can find no evidence of this practice. Yet day after day editorialists and reputable financial writers inveigh against this vicious practice, and yet there is no "bear raiding." It is, of course, quite possible that there has been, and is, some measure of overstatement in these newspaper reports and editorials, but I am convinced that such information would not be published unless there was some basis in fact.

Mr. Whitney has also stated that the exchange is extremely watchful in preventing corners, among other things. And in his speech broadcast from Hartford, Conn., on October 16, 1931, he said, in reference to the ban that had been placed on short selling directly after Great Britain had gone off the gold standard, that—

within two hours after short selling was forbidden, the governing committee found there was a real danger of technical corners and of crazy and dangerous price advances.

I must admit that I can not follow his reasoning. I have a list of securities picked with reference to their volatility, and only in one instance has the oscillation been more than five points. If that constitutes a "crazy advance," I should like to know what the officials of the exchange thought of the advance in the stock of the Vanadium Corporation in 1929 when it was gyrated from $37 to $145. It appears quite evident to me that there was some form of irregularity here; that some group of individuals had cornered the floating supply and had pushed the stock up to the limit. The same may be said of the extraordinary movements of the stock of the Simmons Bed Co. and the United Aircraft Co., not to mention a host of others. Yet I have no recollection of any investigation being held in regard to these apparent irregularities.

Short selling, said Mr. Whitney and Professors Huebner and Lawrence, is not the cause of the depression; the underlying cause is the forced liquidation. And as proof of their contention they submit figures showing that in the bond market, where short selling is practically nonexistent, the decline in the value of bonds has been almost as severe as it has been in the value of stocks. Now, no one, I believe, denies that liquidation was a factor in the bond market and that there was liquidation in the stock market and that, consequently, liquidation has a causal relationship to this depression. But what I deny is the thesis that it is the underlying cause of the depression.

It was the incessant and wanton destruction of security and commodity values by short selling that caused, and is prolonging, the depression. And it is the knowledge and the fear that security and commodity values can be knocked to perdition at will by the short sellers that deters people from investing. And it is this same fear that has caused the liquidation that Mr. Whitney so naively says is the cause of the depression. Prohibit short selling and thereby dispel the fear of huge losses, and liquidation, without question, will cease.

Now, I am forgetting—and this is the point I want to bring home to you gentlemen: I realize that they are trying hard to justify a condition. And I am going to put in the record that in September, 1931, I again wired Mr. Whitney and made it clear to him that if the exchange did not stop short selling of its own volition that Congress would force it to do so. In that wire I said:

> If not in the country's interest, in your own interest stop short selling, at least for the time being, so as to give the country a chance to revive.

And on the next day—or was it the same day?—Great Britain went off the gold standard. You remember that. Most of the stock exchanges closed. The New York Stock Exchange was about to close; but in the morning the governors met. Now, I know that they did not want to issue an order prohibiting short selling that day; but it was a question of closing the Stock Exchange for a few days or stopping the short sales. What did they do?

They put in an order prohibiting all short sales, in an effort to prevent the terrific crash which they expected would ensue from the unfavorable report that Great Britain had gone off the gold standard.

And what was the result? Instead of a crash in prices there was a decided upward movement. I do not know how severe a crash there would have been if the exchange officials had not banned short selling, but there is every reason to believe that it would have been the worst in the history of the exchange. You see the effect, gentlement, of the prohibition of this practice. A report is sent out, "No short selling;" and instead of there being a crash, the market reacts upward. And when the reaction is so pronounced, what do you think they do? Rescind the order. To protect the investors? Not at all. They are afraid that the prices will go up to such heights that the short sellers will receive a deserved whipping. They rescind the order to protect the short sellers. The action of the stock exchange officials makes it so clear that my position has been a correct one that it is not necessary for me to spend more time replying to their futile apologies for their action. They have convicted themselves by that very act, and they stand convicted before the country.

Mr. McKeown. Judge Sabath, how much more time do you want? We are compelled to go to the House early to-day.

Mr. Sabath. Let me say that I am grateful to you for this opportunity and that I will close shortly; and, inasmuch as I have been given the privilege of inserting some of these papers, I will not detain you much longer. I am inclined to think, gentlemen, that you are commencing to feel that I am right on this question.

Mr. Sparks. Judge Sabath, I do not believe that you should assume that we are "commencing" to think that. I think that is an opinion some of the members may have had for some time.

Mr. Yates. I should like to ask a question: I understand, Judge Sabath, that you are discussing the various justifications that have been introduced here; and one of the justifications which they have advanced was the stabilization of the market. And you made the point, as I understand you, that in 1927, 1928, and 1929, they had the power to stabilize and they did not stabilize?

Mr. Sabath. Why, of course—according to that theory they could have done that by selling short at that time. But it did not work that way; so it has been proven that their contention is not worthy of serious consideration.

Mr. McKeown. Well, is it not a matter of fact, Judge Sabath, that the shorts were out of the market at that time, and it went over the long side?

Mr. Sabath. Mr. Chairman and gentlemen, I have tried to point out to all of you this fundamental fact: That all of the present-day "bears" were the "bulls" of 1928 and 1929 who forced the prices of stocks to unreasonable heights; that they are men who are not interested in the effects of their activities so long as they accumulate money. They are a destructive force because they throw our economic system and therefore our social system out of adjustment.

Mr. McKeown. In other words, they take the side that they think they can make the most money out of at a given time?

Mr. Sabath. Yes; and of course they are on both sides at different times.

Mr. Sparks. Perhaps this has been shown in some of the testimony given before the committee; but do you know what the proportion of short selling is, on an average, as compared with the long selling?

Mr. Sabath. That depends on the news they have for dissemination. If they have a chance to send out a lot of detrimental news

which will effect the market, the short selling is much greater. I am of the opinion, from evidence that I have before me and information that I have received from the insiders, that more than 50 per cent of the buying and selling is done by the professional traders; and most of this in the last two years has been short selling. The statistics that Mr. Whitney gives us can not be taken into consideration, because a great number of short sales are covered during the same and succeeding day and these sales do not appear in the figures which he submits. Do you understand?

Mr. SPARKS. Yes.

Mr. SABATH. They liquidate. These shorts, as you no doubt know, do not take any chances. You know the "sure thing" gambler does not take any chance; his reasoning is that no matter how small a profit, it is still a profit.

Mr. CONDON. You have not any evidence of that statement that the shorts do not take any chances, have you? Now, Mr. Whitney made a remark to the effect——

Mr. SABATH (interposing). That they are all "broke"?

Mr. CONDON (continuing. That very few of them come out of the market eventually with a profit.

Mr. SABATH. It is for that reason that I am going to ask early action, and I will tell you why: The outside shorts, that is, those individuals not closely connected with the exchange or with corporations, have not made money; they have lost it, because they are naive enough to believe that they can go in and compete with these professionals and that they can sell short and make money out of it. And it is only the few inside fellows, the floor brokers, the professionals—and there are only a few of them who control the situation—that make money. Ninety or ninety-five per cent of those who go into the market on the long or short side of the market eventually lose everything they have.

Mr. CONDON. It amounts to this: That the outside fellows, the little fellows, who are sometimes "bulls" and sometimes "bears," generally wind up by being "lambs"? [Laughter.]

Mr. SABATH. Yes; they are all "boobs." But in reply to Mr. Whitney's statement relative to all "bears" being "broke," permit me to insert the following statement written by Mr. Leslie Gould which appeared in the Chicago Evening American on February 25, 1932:

If the 1932 bears stick to their announced intention, they may upset that old adage quoted by Whitney, that none of the big shorts in the old days died millionaires. * * *

Since the 1929 market crash the bears have taken rolled up paper profit of upwards of $2,000,000,000, with half of it going to European plungers. In this country 10 bears, it is said, have piled up upwards of $600,000,000.

Here's about the way the $600,000,000 profits is divided:

No. 1 bear	$200,000,000
No. 2 bear	150,000,000
No. 3 bear	50,000,000
No. 4 bear	50,000,000
No. 5 bear	30,000,000
No. 6 bear	25,000,000
No. 7 bear	25,000,000
No. 8 bear	25,000,000
No. 9 bear	10,000,000

Of the 10 above, one—No. 9—died late last year. He had covered nearly all his short lines before his death, so he beat the game.

The other nine are very much alive and kicking. They are the ones who have stepped out of the market, for the time being. * * *

The bears who have clambered to the sidelines are not bullish. * * * They believe there is real danger of legislative action against short selling, both in securities and commodities * * *.

Mr. SPARKS. Do you think there would be a persistency in short selling if these people lost about every time and not ever make a profit?

Mr. SABATH. They would not be there. [Laughter.] Because that is their business; they go there in the morning and watch for the "boobs" and the "lambs" to make their bets, and then they come in. They know what orders have come in during the night; who is pledged to sell; what the conditions are; they go over the reports—there are 7,000 shares of this or that stock that must be sold. Yes; they know that it must be sold by a bank, or by some fellow; and they will go in and start to sell in advance.

Mr. Whitney says that the short seller can not sell for less than the last day's prices. Do you remember when he made that statement? And he also said that one can not sell short for a figure less than the previous long sale. Now, in one breath he says that any restriction on short selling will interfere with the free and open market and in another admits that the exchange is voluntarily restricting the practice itself. But aside from this contradiction, Mr. Chairman, if short selling is proper, if it is helpful to the market, if it is beneficial to the country, why should the exchange pass such rules? There is only one answer: All of these rules have been passed with one purpose in mind—to forestall congressional regulation. And though they may present some difficulties for the small short seller to surmount, they do not deter the big "bear" operators in their activities. Mr. R. P. Vanderpool, writing in the Chicago Evening American on February 25, 1932, brings this out quite clearly:

Some time ago the New York Stock Exchange adopted certain rules regarding short selling.

We are not sure with what sincerity these regulations were made—whether they were just sop to public demand or were seriously intended to correct abuses connected with short selling.

At any rate, the regulations are not proving effective in preventing bear raiding, and we propose within the next few days to point out some of the means used to evade these restrictions.

To-day we shall disclose a popular method of avoiding the New York Stock Exchange rule that a short sale may not be made at a price below the last previous sale. The exchange points to this regulation as a certain preventative of short selling depressing the market.

JIM AND BILL

Jim Smith and Bill Brown are a couple of bears. The last sale of Steel has been at 45⅞. The market is now 45⅞ to 46⅛. Jim and Bill arrange to cross 50,000 shares of Steel at 46, Bill being long on the stock and Jim short. Jim, of course, has no difficulty in borrowing the stock from his pal, Bill.

Bill waits until some bad news comes out and the market looks vulnerable. He then throws his 50,000 shares of Steel on the market in the hope that this concentrated selling will demoralize the market, bring out stop-loss orders and in general cause sufficient liquidation to permit Jim to buy the stock back at a lower average price than Bill sold on the decline.

NOT LEGITIMATE

In our opinion, this whole thing is not a legitimate transaction. It is essentially bear raiding. We are told that it is being practiced extensively in New York.

Members of the New York Stock Exchange tell us that, while a transaction of this sort might not be easy to control, they believe the governors of the New York exchange could certainly make it much more difficult and possibly eliminate it altogether, if they sincerely desired.

Oh, yes! Mr. Whitney has issued a statement saying that there will be a more stringent rule imposed by the exchange on the short sellers, and that from now on everyone will have to sign an order agreeing that his stock may be loaned. We are told that the order is to go into effect April 1. Now, let us see: What is April 1? Is it not "April Fools' Day"? Well, I think that is just what this order is—a hoax to fool the people, to fool you, Mr. Chairman and gentlemen, and everyone, so that you will desist from your efforts to legislate on this question.

But I wonder why that order was issued? I understand that a few days before the statement of that proposed ruling appeared in the press, Mr. Whitney had a conference with the President, though this is not the only conference which the President has had in this regard; for right here I want to be fair and say that I also conferred with him on this question of short selling some time ago——

Mr. CONDON (interposing). How long ago?

Mr. SABATH. Nearly a year ago. Yes. And he criticized short selling——

Mr. CONDON (interposing). Did he say that publicly, or just in a letter to you?

Mr. SABATH. Oh, publicly; he criticized short selling in a letter which was published—this occurred about the time the press first carried reports that Russia had sold 7,000,000 bushels of wheat short.

Mr. CONDON. That particular statement of his referred only to short selling on the commodities exchange, did it not?

Mr. SABATH. I know; but also in a measure it showed his inclinations and that he was commencing to realize that short selling was detrimental.

And I warned him on that point. I told him what he could do to protect the interest of the American wheat grower. And it is to be regretted that he has not followed his original talk, namely, in helping me to bring about this legislation, as he has done in other matters. This is not the only matter I had discussed with him and pleaded for. I pleaded for the Finance Corporation legislation; the broadening of the Federal Reserve Board's power of rediscount; and the creation of a home loan banking system. He adopted these three and I thought I had him with me on this also; but unfortunately, after a conference with a certain influential lawyer, the lawyer from the Chicago Board of Trade——

Mr. CONDON (interposing). Mr. Strawn?

Mr. SABATH. Mr. Strawn, notwithstanding the fact that the United States Chamber of Commerce had gone on record against short selling, and that he was the chairman of it, he appeared before the President three or four months ago, and pointed out to him the necessity of short selling and probably convinced him of desisting in his efforts to stop short selling.

Mr. MCKEOWN. Mr. Sabath, we will have to suspend now, as the House is in session.

Mr. SABATH. Now, Mr. Chairman, I want to say this in conclusion: I have here resolutions and copies of resolutions by bankers' associations; by the United States Chamber of Commerce; and by the various farm organizations throughout the country. I have here statements from professors, students, and economists who are not controlled by Wall Street. I have letters from hundreds of bankers and others who have suffered—men who were formerly members of the stock exchange—all appealing for relief and asking that we put an end to this practice. And therefore, I hope that favorable action will be taken.

Now, Mr. Chairman, though I have been fighting this practice for nearly two years and a half and have introduced several measures regulating it, I wish to say that I am not wedded to my bills. I am interested in the principle—the elimination of this evil. We have a drafting bureau here, and we are paying a good, substantial salary to these gentlemen, and they are efficient. They can draw a bill that will be constitutional, and that will eliminate this evil.

I have been working on another bill, that I hope will come to this committee, which, I believe, is constitutional, and which will be much broader in scope than either of my first two bills, or the "blue sky" bill. I hope that it will be sent to this committee shortly. And I hope you will give all of these bills the consideration to which, I believe, they are entitled.

I thank you, Mr. Chairman and gentlemen, for the courtesy you have extended to me.

Mr. MCKEOWN. We thank you very much, Judge Sabath, for your interesting and instructive statement. The subcommittee will now stand adjourned, subject to call of the chairman.

(Thereupon, at 11.20 o'clock a. m., the subcommittee adjourned, subject to the call of the chairman.)

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